Hot Topics and New Developments in Estate Planning

November 13, 2020

12:00 p.m. – 1:15 p.m.

CT Bar Association

Webinar

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LAWYERS' PRINCIPLES OF PROFESSIONALISM

As a lawyer, I have dedicated myself to making our system of justice work fairly and efficiently for all. I am an officer of this Court and recognize the obligation I have to advance the rule of law and preserve and foster the integrity of the legal system. To this end, I commit myself not only to observe the Connecticut Rules of Professional Conduct, but also conduct myself in accordance with the following Principles of Professionalism when dealing with my clients, opposing parties, fellow counsel, self-represented parties, the Courts, and the general public.

Civility:

Civility and courtesy are the hallmarks of professionalism. As such,

- I will be courteous, polite, respectful, and civil, both in oral and in written communications;
- I will refrain from using litigation or any other legal procedure to harass an opposing party;
- I will not impute improper motives to my adversary unless clearly justified by the facts and essential to resolution of the issue;
- I will treat the representation of a client as the client's transaction or dispute and not as a dispute with my adversary;
- I will respond to all communications timely and respectfully and allow my adversary a reasonable time to respond;
- I will avoid making groundless objections in the discovery process and work cooperatively to resolve those that are asserted with merit;
- I will agree to reasonable requests for extensions of time and for waiver of procedural formalities when the legitimate interests of my client will not be adversely affected;
- I will try to consult with my adversary before scheduling depositions, meetings, or hearings, and I will cooperate with her when schedule changes are requested;
- When scheduled meetings, hearings, or depositions have to be canceled, I will notify my adversary and, if appropriate, the Court (or other tribunal) as early as possible and enlist their involvement in rescheduling; and
- I will not serve motions and pleadings at such time or in such manner as will unfairly limit the other party's opportunity to respond.

Honesty:

Honesty and truthfulness are critical to the integrity of the legal profession – they are core values that must be observed at all times and they go hand in hand with my fiduciary duty. As such,

- I will not knowingly make untrue statements of fact or of law to my client, adversary or the Court;
- I will honor my word;
- I will not maintain or assist in maintaining any cause of action or advancing any position that is false or unlawful;

- I will withdraw voluntarily claims, defenses, or arguments when it becomes apparent that they do not have merit or are superfluous;
- I will not file frivolous motions or advance frivolous positions;
- When engaged in a transaction, I will make sure all involved are aware of changes I make to documents and not conceal changes.

Competency:

Having the necessary ability, knowledge, and skill to effectively advise and advocate for a client's interests is critical to the lawyer's function in their community. As such,

- I will keep myself current in the areas in which I practice, and, will associate with, or refer my client to, counsel knowledgeable in another field of practice when necessary;
- I will maintain proficiency in those technological advances that are necessary for me to competently represent my clients.
- I will seek mentoring and guidance throughout my career in order to ensure that I act with diligence and competency.

Responsibility:

I recognize that my client's interests and the administration of justice in general are best served when I work responsibly, effectively, and cooperatively with those with whom I interact. As such,

- Before dates for hearings or trials are set, or if that is not feasible, immediately after such dates have been set, I will attempt to verify the availability of key participants and witnesses so that I can promptly notify the Court (or other tribunal) and my adversary of any likely problem;
- I will make every effort to agree with my adversary, as early as possible, on a voluntary exchange of information and on a plan for discovery;
- I will attempt to resolve, by agreement, my objections to matters contained in my opponent's pleadings and discovery requests;
- I will be punctual in attending Court hearings, conferences, meetings, and depositions;
- I will refrain from excessive and abusive discovery, and I will comply with all reasonable discovery requests;
- In civil matters, I will stipulate to facts as to which there is no genuine dispute;
- I will refrain from causing unreasonable delays;
- Where consistent with my client's interests, I will communicate with my adversary in an effort to avoid needless controversial litigation and to resolve litigation that has actually commenced;
- While I must consider my client's decision concerning the objectives of the representation, I nevertheless will counsel my client that a willingness to initiate or engage in settlement discussions is consistent with zealous and effective representation.

Mentoring:

I owe a duty to the legal profession to counsel less experienced lawyers on the practice of the law and these Principles, and to seek mentoring myself. As such:

- I will exemplify through my behavior and teach through my words the importance of collegiality and ethical and civil behavior;
- I will emphasize the importance of providing clients with a high standard of representation through competency and the exercise of sound judgment;
- I will stress the role of our profession as a public service, to building and fostering the rule of law;
- I will welcome requests for guidance and advice.

Honor:

I recognize the honor of the legal profession and will always act in a manner consistent with the respect, courtesy, and weight that it deserves. As such,

- I will be guided by what is best for my client and the interests of justice, not what advances my own financial interests;
- I will be a vigorous and zealous advocate on behalf of my client, but I recognize that, as an officer of the Court, excessive zeal may be detrimental to the interests of a properly functioning system of justice;
- I will remember that, in addition to commitment to my client's cause, my responsibilities as a lawyer include a devotion to the public good;
- I will, as a member of a self-regulating profession, report violations of the Rules of Professional Conduct as required by those rules;
- I will protect the image of the legal profession in my daily activities and in the ways I communicate with the public;
- I will be mindful that the law is a learned profession and that among its desirable goals are devotion to public service, improvement of administration of justice, and the contribution of uncompensated time and civic influence on behalf of those persons who cannot afford adequate legal assistance; and
- I will support and advocate for fair and equal treatment under the law for all persons, regardless of race, color, ancestry, sex, pregnancy, religion, national origin, ethnicity, disability, status as a veteran, age, gender identity, gender expression or marital status, sexual orientation, or creed and will always conduct myself in such a way as to promote equality and justice for all.

Nothing in these Principles shall supersede, supplement, or in any way amend the Rules of Professional Conduct, alter existing standards of conduct against which a lawyer’s conduct might be judged, or become a basis for the imposition of any civil, criminal, or professional liability.

Hot Topics and New Developments in Estate Planning (FTINE201113)

Friday, November 13, 2020
12:00 p.m. – 1:15 p.m.

Speakers

Turney P. Berry, Wyatt Tarrant & Combs LLP, Louisville, KY
Charles A. Redd, Stinson LLP, St. Louis, MO

Agenda

I. Tax Reform Provides Significant Changes for Estate Planners
II. Secure Act
III. Estate Planning Practice in 2018 and Beyond
IV. Federal Rulings, Cases, and Other Developments
V. State Developments
VI. 2020 Kentucky Legislative Changes

Faculty Biographies

Turney P. Berry concentrates his practice in the areas of estate planning, fiduciary matters, and charitable planning. Mr. Berry is Chair of Wyatt, Tarrant & Combs' Trusts, Estates & Personal Planning Service Team and a past member of the firm's Executive Committee.

Mr. Berry is active in the American College of Trust and Estate Counsel (ACTEC), and has served as President of the ACTEC Foundation, Regent of the College, State Chair for Kentucky, Chair of the Estate & Gift Committee, and Chair of the Charitable and Tax Exempt Committee. Currently he serves as a member of the State Laws Committee, Long Range Planning Committee and as the ACTEC Liaison to the Uniform Law Commission.

As a Uniform Law Commissioner, Mr. Berry currently serves as Co-Chair of the Drafting Committee on Economic Rights of Unmarried Cohabitants Act, Member of the Drafting Committee on Revised Disposition of Community Property Rights at Death Act, and Vice-Chair of the Drafting Committee on Conflicts of Laws in Trusts and Estates, and Member of the Joint Editorial Board for Uniform Trust and Estate Acts. He has served as chair of the Uniform Fiduciary Income and Principal Act (UFIPA), chair of the Uniform Power of Appointment Act, Vice Chair of the Drafting Committee on Electronic Wills Act, and as a member of the drafting committees for the Directed Trust Act, the Revised Fiduciary Access to Digital Assets Act, the Trust Decanting Act, the Insurable Interests in Trusts Act, the Premarital and Marital Agreements Act, the Transfer on Death Deeds Act, and the Uniform Probate Code Artificial Reproductive Technology provisions, and an adjunct member of the Fundraising Through Public Appeals Act.

Mr. Berry is a Fellow of the American College of Tax Counsel, a member of the American Law Institute, a member of the Advisory Council of the <u>Heckerling Institute on Estate Planning</u>, a Member of the Advisory Board of <u>Trusts and Estates Monthly</u>, a member of the Joint Editorial Board for Uniform Trust and Estates Act, and a member of the Bloomberg BNA Tax Advisory Board (Estates, Gifts, and Trusts). He serves as Adjunct Professor at the University of Miami Estate Planning LLM Program (Business Succession Planning), and has served as Adjunct Professor at Vanderbilt University, the University of Missouri, and the University of Louisville, and regularly speaks at the nation's leading estate planning conferences. Since 1996, Mr. Berry has served as Co-Chair of the Midwest/Midsouth Estate Planning Institute at the University of Kentucky (the longest continuously run CLE event in Kentucky).

Mr. Berry has been certified as an Accredited Estate Planner® (AEP®) by the National Association of Estate Planners & Councils and is a member of its Estate Planning Hall of Fame [Kentucky does not recognize legal specialties]. He is listed in Woodward/White's <u>The Best Lawyers in America</u>® and in the Kentucky Super Lawyer Magazine in the area of Trusts and Estates.

Mr. Berry is the author or co-author of three Tax Management Portfolios: <u>Estate Tax Deductions - Sections 2053 and 2054</u>; <u>Private Foundations - Self Dealing - Section 4941</u>; and <u>Taxable Expenditures - Section 4945</u>. In addition he is co-author of <u>Trust Law in Kentucky</u> (in progress) and his frequent articles have appeared in numerous journals and magazines. Mr. Berry received the Texas Bar Foundation Outstanding Law Review Article award for an article he co-authored with Paul Lee titled "Retaining, Sustaining and Obtaining Basis" which was published by the Texas Tech Estate Planning and Community Property Law Journal in January 2015

Mr. Berry has been an Articles Editor of *The Tax Lawyer* and a past chair of the Louisville Bar Association Probate and Estate Planning Section (1989 Section of the Year). He is a member of the Louisville Estate Planning Council, Kentuckiana Planned Giving Council, and an adjunct member of the American Association of Life Underwriters.

Mr. Berry is Chair of the Center for Interfaith Relations, and Earth School/Carbon Nation. He is a member of Louisville Downtown Rotary, and a Member of the Honorable Order of Kentucky Colonels. He is a past member of the Board of Directors for the Muhammad Ali Center, Kentucky Opera, Actors Theatre, the Filson Historical Society, the Louisville Science Center, among others, as well as past President of the Daily Bread Sunday School Class at Christ Church United Methodist. Mr. Berry is the recipient of the National Philanthropy Day Baylor Landrum Award and has been recognized as a Distinguished Citizen of Louisville.

A native of Tennessee, Mr. Berry received his B.A. and B.L.S. in 1983 from the University of Memphis and his J.D. in 1986 from Vanderbilt University.

CHARLES A. REDD

Charles A. Redd is a partner in the St. Louis, Missouri, office of the law firm of STINSON LLP. Mr. Redd concentrates his practice in estate planning, estate and trust administration and estate and trust-related litigation. Prior to joining Stinson, Mr. Redd was a partner in and Vice Chairman of the Trusts & Estates Practice Group at the law firm of SNR Denton US LLP (now Dentons US LLP). Mr. Redd was also previously a partner in the law firm of Armstrong, Teasdale, Schlafly & Davis (now Armstrong Teasdale LLP) and was Chairman of that firm's Trusts & Estates Department. He was previously employed as a Trust Administrator by First Wisconsin Trust Company (now U.S. Bank, N.A.), Milwaukee, Wisconsin, and as an Assistant Counsel by Centerre Trust Company of St. Louis (now Bank of America Private Bank).

Mr. Redd has extensive experience and expertise in: (a) the drafting of wills, trust instruments, durable powers of attorney, marital agreements and other estate planning documents; (b) pre- and post-death tax planning for individuals, trusts and estates; (c) preparation and filing of estate tax returns, gift tax returns and fiduciary income tax returns; (d) representation and filing of estate tax returns, gift tax returns and fiduciary income tax returns; (e) representation of individual and corporate fiduciaries and (f) litigation in the Probate Division and other equity divisions of the Circuit Court. Mr. Redd has worked on estates and estate planning projects, some involving assets valued at over a billion dollars, and has successfully handled numerous estate tax, gift tax and generation-skipping transfer tax matters, will and trust construction cases, will contests, contests of trust agreements, alleged breach of fiduciary duty cases and other types of cases involving estates and trusts.

Mr. Redd is a member of the State Bar of Wisconsin, The Missouri Bar, the Illinois State Bar Association, The Bar Association of Metropolitan St. Louis, and the Estate Planning Council of St. Louis.

Mr. Redd was Chairman of the Missouri Bar's Health Care Durable Power of Attorney Subcommittee, and he played a significant role in the drafting and enactment of the Missouri Durable Power of Attorney for Health Care Act. In 1991, Mr. Redd received The Missouri Bar President's Award. Mr. Redd was the principal draftsman of the recently enacted Missouri Family Trust Company Act.

Mr. Redd is an elected member of The American Law Institute and a Fellow of The American College of Trust and Estate Counsel (Past Missouri State Chair; Past Regent; Communications Committee (Past Chair); Estate and Gift Tax Committee; and Fiduciary Litigation Committee). He was an adjunct professor of law (Estate Planning) at Northwestern University School of Law for fifteen years. He serves as Co-Chair of the Editorial Advisory Board of, and writes a regular column in, TRUSTS & ESTATES magazine. In 2018, he was inducted into the Estate Planning Hall of Fame® by the National Association of Estate Planners and Councils. Mr. Redd is listed in The Best Lawyers in America and is "Band 1" ranked by Chambers and Partners in their High Net Worth guide. He frequently writes and lectures nationally on topics in the trusts and estates field.

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NOTABLE DEVELOPMENTS OF INTEREST TO ESTATE PLANNERS

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Disclaimer: This information is intended as a resource for attorneys and wealth management professionals, but it does not constitute legal advice and reliance thereon does not establish an attorney-client relationship. This information is not a substitute for an attorney's judgment and application of the relevant law to a client's circumstances.

The author thanks Charles A. Redd for his contribution to these materials. Mistakes are the author's own.

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NOTABLE DEVELOPMENTS OF INTEREST TO ESTATE PLANNERS

PART 1 – TAX REFORM PROVIDES SIGNIFICANT CHANGES FOR ESTATE PLANNERS

On December 22, 2017 was enacted "An Act To Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018," Pub. L. No. 115-97, ("2017 Tax Act"). The 2017 Tax Act makes significant income tax changes, the effects of which will not really be understood for some time, particularly after regulations are issued. The major transfer tax change is the doubling of the wealth transfer exclusion.

A. Effective Date and Sunset

Most provisions in the 2017 Tax Act became effective January 1, 2018. Except with respect to the change in the calculation of inflation adjustments, many of the changes to business taxes and other changes, discussed below, many of the provisions of the 2017 Tax Act will sunset on January 1, 2026 and the law in effect on December 31, 2017 will become effective again, unless legislation is enacted altering this sunset.

B. New Basic Exclusion Amounts for Estate and Gift Taxes and New Generation-Skipping Transfer Exemption and Clawback

For estate and gift tax purposes, the 2017 Tax Act increased the basic exclusion amount under section 2010(c)(3) to $10 million as adjusted for inflation with a 2010 base year (the same base year as under prior law). Thus, the basic exclusion amount for 2020 for gift and estate tax purposes, and the generation-skipping transfer ("GST") exemption amount under section 2631(c), is $11,580,000. Under the current applicable exclusion amount, the number of decedent's estates subject to federal estate tax may only reach a few thousand, and taxpayers have the ability to make larger gifts during their lives free of gift tax. Just as important, taxpayers with less than the exclusion amount may transfer assets among themselves in order to include assets in the estate of a taxpayer most likely to die soonest. This creates enormous basis planning opportunities.

On November 26, 2019, final clawback regulations were issued (§20.2010-1(c)). T.D. 9884. In a nutshell, the regulations take the positions that (1) donors who paid gift tax on gifts prior to 2017 in excess of the original basic exclusion amount can make up to $5 million of gifts in 2018-2025 which will be protected from tax by the additional basic exclusion amount and (2) donors who die <u>after</u> 2025 and who made gifts in 2018-2025 that were protected from gift tax by the additional basic exclusion amount will be able to preserve the additional basic exclusion amount used against those gifts when their estate taxes are determined. So there is no "clawback" <u>but</u> in order to preserve the additional basic exclusion amount, a gift will have to be made. In other words, a donor who makes only a $5 million gifts before 2025 and dies after 2025 will not benefit from the additional exclusion.

Suppose the first spouse dies before 2026 and portability is elected. The surviving spouse may use the full unused exclusion amount of the first spouse, even after January 1, 2026. Examples 3 and 4 of the final regulations state:

(iii) Example 3. Individual B's predeceased spouse, C, died before 2026, at a time when the basic exclusion amount was \$11.4 million. C had made no taxable gifts and had no taxable estate. C's executor elected, pursuant to §20.2010-2, to allow B to take into account C's \$11.4 million DSUE amount. B made no taxable gifts and did not remarry. The basic exclusion amount on B's date of death is \$6.8 million. Because the total of the amounts allowable as a credit in computing the gift tax payable on B's post-1976 gifts attributable to the basic exclusion amount (zero) is less than the credit based on the basic exclusion amount allowable on B's date of death, this paragraph (c) does not apply. The credit to be applied for purposes of computing B's estate tax is based on B's \$18.2 million applicable exclusion amount, consisting of the \$6.8 million basic exclusion amount on B's date of death plus the \$11.4 million DSUE amount, subject to the limitation of section 2010(d).

(iv) Example 4. Assume the facts are the same as in Example 3 of paragraph (c)(2)(iii) of this section except that, after C's death and before 2026, B makes taxable gifts of \$14 million in a year when the basic exclusion amount is \$12 million. B is considered to apply the DSUE amount to the gifts before applying B's basic exclusion amount. The amount allowable as a credit in computing the gift tax payable on B's post-1976 gifts for that year (\$5,545,800) is the tax on \$14 million, consisting of \$11.4 million in DSUE amount and \$2.6 million in basic exclusion amount. This basic exclusion amount is 18.6 percent of the \$14 million exclusion amount allocable to those gifts, with the result that \$1,031,519 (0.186 x \$5,545,800) of the amount allowable as a credit for that year in computing gift tax payable is based solely on the basic exclusion amount. The amount allowable as a credit based solely on the basic exclusion amount for purposes of computing B's estate tax (\$2,665,800) is the tax on the \$6.8 million basic exclusion amount on B's date of death. Because the portion of the credit allowable in computing the gift tax payable on B's post-1976 gifts based solely on the basic exclusion amount (\$1,031,519) is less than the credit based solely on the basic exclusion amount (\$2,665,800) allowable on B's date of death, this paragraph (c) does not apply. The credit to be applied for purposes of computing B's estate tax is based on B's \$18.2 million applicable exclusion amount, consisting of the \$6.8 million basic exclusion amount on B's date of death plus the \$11.4 million DSUE amount, subject to the limitation of section 2010(d).

The Preamble also has an odd "warning" styled an Anti-abuse Rule which states:

6. Anti-abuse Rule

A commenter recommended consideration of an anti-abuse provision to prevent the application of the special rule to transfers made during the increased BEA period that are not true inter vivos transfers, but rather are treated as testamentary transfers for transfer tax purposes. Examples include transfers subject to a retained life estate or other retained powers or interests, and certain transfers within the purview of chapter 14 of subtitle B of the Code. The purpose of the special rule is to ensure that bona fide inter vivos transfers are not subject to inconsistent treatment for estate tax purposes. Arguably, the possibility of inconsistent treatment does not arise with regard to transfers that are treated as part of the gross estate for estate tax purposes, rather than as adjusted taxable gifts. An anti-abuse provision could except from the application of the special rule transfers where value is included in the donor's gross estate at death. Although the Treasury Department and the IRS agree that such a provision is within the scope of the regulatory authority granted in section 2001(g)(2), such an anti-abuse provision

> would benefit from prior notice and comment. Accordingly, this issue will be reserved to allow further consideration of this comment.

Chapter 14 has certain deemed valuation rules for preferred partnerships that could fall within the scope of this reservation. Other areas of concern would be gifts with retained income interests – those use current exclusion as completed gifts but require subsequent estate income so that the donor gets a basis step-up at death; consider a common-law GRIT for instance.

The 2017 Tax Act did not change the transfer tax rates. The regulations dealing with clawback do not mention GST because, the Preamble states, GST is beyond the scope of the project. However, the Preamble also notes that nothing in the statute indicates that sunset would affect allocation of GST exemption when available.. The Blue Book stated that during 2018-2025 additional GST exemption was available. Presumably Treasury does not believe that exemption disappears once allocated.

C. <u>Inflation Adjustments</u>

All provisions in the Code that provide amounts subject to indexing for inflation will use the chained consumer price index for all urban consumers ("C-CPI-U" or "Chained Consumer Price Index"). Section 1(f)(6); 2017 Tax Act § 11002. This inflation adjustment method is a permanent change to the Code. The use of the Chained Consumer Price Index will result in slower growth of inflation and a slower increase in basic exclusion amount than the prior method, the Consumer Price Index for all Urban Consumers, or CPI-U. It will also cause more taxpayers to be in higher tax brackets over time which is a partial undoing of the effects of ERTA from 1981.

D. <u>Miscellaneous Itemized Deductions</u>.

Miscellaneous itemized deductions subject to the 2% floor under Section 67(a)-(b) are suspended. Section 67(g).

Because many states base their income tax calculation on federal taxable income, the elimination of many itemized deductions due to Section 67(g) will increase state income taxes for many individuals, trusts and estates as well. Some states have attempted to recast those deductions as charitable contributions. To date, those efforts have failed. In fact, those efforts have done affirmative harm. Previously, the IRS took the position that a state tax credit received for a charitable contribution would not reduce the donor's income tax deduction. <u>See</u> CCA201105010. But the IRS has a new position now: a tax credit is a quid pro quo. TD 9864 (June 11, 2019). The Preamble explains:

> The new limitation, and the resulting efforts by states and taxpayers to devise alternate means for deducting the disallowed portion of their state and local taxes, has generated increased interest in the question of whether a state or local tax credit should be treated as a return benefit – a <u>quid pro quo</u> – when received in return for making a payment or transfer to an entity described in section 170(c). The Treasury Department and the IRS did not publish formal guidance on this question before the enactment of the limitation under section 164(b)(6). In 2010, however, the IRS Chief Counsel advised that, under certain circumstances, a taxpayer may take a deduction under section 170 for the full amount of a

> contribution made in exchange for a state tax credit, without subtracting the value of the credit received in return. See CCA 201105010 (Oct. 27, 2010) ("the 2010 CCA"). IRS Chief Counsel has also taken the position in Tax Court litigation that the amount of a state or local tax credit that reduces a tax liability is not an accession to wealth includible in income under section 61 or an amount realized for purposes of section 1001. In these cases, the Tax Court agreed with the Chief Counsel's position. See, for example, Maines v. Commissioner, 144 T.C. 123, 134 (2015); Tempel v. Commissioner, 136 T.C. 341, 351-54 (2011); aff'd sub nom. Esgar Corp. v. Commissioner, 744 F.3d 648 (10th Cir. 2014).
>
> Upon reviewing the authorities under section 170, the Treasury Department and the IRS questioned the reasoning of the 2010 CCA. On June 11, 2018, the Treasury Department and the IRS issued Notice 2018-54, 2018-24 I.R.B. 750, announcing the intention to propose regulations addressing the federal income tax treatment of contributions pursuant to state and local tax credit programs. On August 27, 2018, the proposed regulations (REG-112176-18) were published in the **Federal Register** (83 FR 43563).
>
> The proposed regulations generally stated that if a taxpayer makes a payment or transfers property to or for the use of an entity listed in section 170(c), and the taxpayer receives or expects to receive a state or local tax credit in return for such payment, the tax credit constitutes a return benefit, or quid pro quo, to the taxpayer and reduces the taxpayer's charitable contribution deduction. The proposed regulations included a separate rule for state and local tax deductions, providing that they do not constitute a quid pro quo unless they exceed the amount of the donor's payment or transfer. The proposed regulations also included an exception under which a state or local tax credit is not treated as a quid pro quo if the credit does not exceed 15 percent of the taxpayer's payment or 15 percent of the fair market value of the property transferred by the taxpayer. Finally, the proposed regulations would amend §1.642(c)-3 to provide similar rules for payments made for a purpose specified in section 170(c) by a trust or decedent's estate.
>
> The Treasury Department and the IRS received over 7,700 comments responding to the proposed regulations and 25 requests to speak at the public hearing, which was held on November 5, 2018. Copies of written comments received and the list of speakers at the public hearing are available for public inspection at www.regulations.gov or upon request. The comments and revisions are discussed generally in this preamble. After considering the comments received and the concerns expressed at the public hearing, the Treasury Department and the IRS adopt the proposed regulations with certain revisions explained subsequently.

Note that this does not include expenses of an estate or trust not subject to the 2% floor under section 67(e). Expenses of an estate or trust are not subject to the 2% floor if such expenses would not have been incurred if the property were not held in a trust or estate. Thus, executor and trustee fees and attorney's fees related to trust and estate administration should continue to be deductible.

The income tax deduction for estate tax attributable to income in respect of a decedent under section 691(c) was not altered by the 2017 Tax Act.

Section 642(h)(2) states that on termination of an estate or trust any deductions (other than the estate or trust exemption and other than the charitable deduction) for the estate or trust in excess of gross income are allowable as deductions to the beneficiaries. This deduction is eliminated due the suspension of miscellaneous itemized deductions for individuals under section 67(g). Beneficiaries may still claim a trust or estate's net operating losses or capital loss carryovers upon trust or estate termination under section 642(h)(1). The IRS and Treasury have issued generally taxpayer-friendly proposed regulations dealing with section 67(g). REG-113295-18. The summary states:

> This document contains proposed regulations clarifying that the following deductions allowed to an estate or non-grantor trust are not miscellaneous itemized deductions: costs paid or incurred in connection with the administration of an estate or non-grantor trust that would not have been incurred if the property were not held in the estate or trust, the personal exemption of an estate or non-grantor trust, the distribution deduction for trusts distributing current income, and the distribution deduction for estates and trusts accumulating income. Therefore, these deductions are not affected by the suspension of the deductibility of miscellaneous itemized deductions for taxable years beginning after December 31, 2017, and before January 1, 2026.

The proposed regulations provide that 67(e) expenses remain in categories as they pass out to beneficiaries; the Explanation of Provision states:

> The Treasury Department and the IRS adopt the more specific suggestion from commenters of preserving the tax character of the three categories of expenses, rather than the suggestion of grouping all non-section 67(e) expenses together, to allow for such expenses to be separately stated and to facilitate reporting to beneficiaries. Thus, under these proposed regulations, each deduction comprising the section 642(h)(2) excess deduction retains its separate character, specifically: as an amount allowed in arriving at adjusted gross income; a non-miscellaneous itemized deduction; or a miscellaneous itemized deduction. The character of these deductions does not change when succeeded to by a beneficiary on termination of the estate or trust. Further, these proposed regulations require that the fiduciary separately state (that is, separately identify) deductions that may be limited when claimed by the beneficiary as provided in the instructions to Form 1041, U.S. Income Tax Return for Estates and Trusts and the Schedule K-1 (Form 1041), Beneficiary's Share of Income, Deductions, Credit, etc.
>
> The proposed regulations adopt the suggestion that the principles under §1.652(b)-3 be used to allocate each item of deduction among the classes of income in the year of termination for purposes of determining the character and amount of the excess deductions under section 642(h)(2). Section 1.652(b)-3(a) provides that deductions directly attributable to one class of income are allocated to that income. Any remaining deductions that are not directly attributable to a specific class of income, as well as any deductions that exceed the amount of directly attributable income, may be allocated to any item of income (including capital gains), but a portion must be allocated to tax-exempt income, if any. See §1.652(b)-3(b) and (d). The proposed regulations provide that the character and amount of each deduction remaining after application of §1.652(b)-3 comprises the excess deductions available to the beneficiaries succeeding to the property as provided under section 642(h)(2).

The pro rata allocation among beneficiaries is retained, as this from the Explanation notes:

> Existing regulations under §1.642(h)-4 provide that carryovers and excess deductions to which section 642(h) applies are allocated among the beneficiaries succeeding to the property of an estate or trust proportionately according to the share of each in the burden of the loss or deduction. A person who qualifies as a

> beneficiary succeeding to the property of an estate or trust with respect to one amount and who does not qualify with respect to another amount is a beneficiary succeeding to the property of the estate or trust as to the amount with respect to which the beneficiary qualifies. These proposed regulations do not change the allocation method among beneficiaries set forth in §1.642(h)-4.

Subsection (c) of the regulation states:

> (c) Year of termination — (1) In general. The deductions provided for in paragraph (a) of this section are allowable only in the taxable year of the beneficiary in which or with which the estate or trust terminates, whether the year of termination of the estate or trust is of normal duration or is a short taxable year.
>
> (2) Example. Assume that a trust distributes all its assets to B and terminates on December 31, Year X. As of that date, it has excess deductions of $18,000, all characterized as allowable in arriving at adjusted gross income under section 67(e). B, who reports on the calendar year basis, could claim the $18,000 as a deduction allowable in arriving at B's adjusted gross income for Year X. However, if the deduction (when added to B's other deductions) exceeds B's gross income, the excess may not be carried over to any year subsequent to Year X.

There is also a new example dealing with net operating loss carryovers.

Section 643(f) provides that, for purposes of subchapter J of the Code (§§ 641-685), pursuant to regulations, two or more trusts shall be treated as one trust if: (1) such trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries and (2) a principal purpose of such trust is the avoidance of the income tax. For purposes of section 643(f), spouses shall be treated as one person. No regulations have been issued under this subsection.

E. **Divorce – Income Tax**.

The 2017 Tax Act repealed section 682, which provided that if one spouse created a grantor trust for the benefit of the other spouse and the spouses divorced, thereafter the trust income would not be taxed to the grantor spouse to the extent of any income that the donee-spouse is entitled to receive. These changes are effective for divorce decrees and separation agreements entered into after 2018. Thus, taxpayers seeking a divorce during 2018 will likely benefit if the divorce is finalized before the end of the calendar year. Modifications entered into after 2018 are subject to the 2017 Tax Act if the modification expressly states that this provision of 2017 Tax Act applies. 2017 Tax Act § 11051(c)(2). No sunset applies to the repeal of the above provisions regarding alimony and separate maintenance payments and section 682. The IRS intends to issue regulations regarding the application of section 682 before its repeal is effective. Notice 2018-37. In the Notice, the IRS requested comments on whether guidance is needed regarding the application of sections 672(e)(1)(A), 674(d), and 677 following a divorce or separation in light of the repeal of section 682.

In light of the repeal of section 682, sections 672(e)(1)(A), 674(a) and 677(a) may have the effect of triggering grantor trust status due to the non-grantor spouse's powers over a trust even after the spouses divorce. Section 672(e)(1)(A) provides that the grantor of a trust shall be treated as holding any power or interest in such trust held by any individual who was the spouse of the grantor at the time of the creation of such power or interest. Section 674(a) provides, in general, that the grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the trust assets is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party. However, section 674(d) provides that section 674(a) shall not apply to a power solely exercisable (without the approval or consent of any other person) by a Trustee or Trustees, none of whom is the grantor or spouse living with the grantor, to distribute, apportion or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries, if such power is limited by a reasonably definite external standard that is set forth in the trust instrument. Section 677(a) provides that the grantor of a trust shall be treated as the owner of any portion of a trust, whether or not the grantor is treated as such owner under section 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be distributed to the grantor or the grantor's spouse, or held or accumulated for future distribution to the grantor or the grantor's spouse.

F. Basis of Life Insurance Policies.

For purposes of life settlements of life insurance policies, the 2017 Tax Act provides that a taxpayer's basis in a life insurance policy is not reduced by the cost of insurance. This provision reverses the IRS's position, stated in Rev. Rul. 2009-13 that a taxpayer's basis does include such charges. Accordingly, the IRS has issued Rev. Rul. 2020-05 which revises the examples to reflect the change.

New reporting requirements are imposed for life settlements. Section 6050Y. The transfer for value rules are excluded from life settlements. Section 101(a)(2). These provisions do not sunset after 2025.

PART 2 - SECURE ACT

The following summary of changes made by and planning implications of the SECURE Act are based on resources from Steve Akers (used with permission).

A. Generally.

The SECURE Act (H.R. 1994, Setting Every Community Up for Retirement Enhancement Act of 2019) was a proposal to make various changes regarding retirement benefits. The SECURE Act was included as Division O of the late 2019 "spending bill," H.R. 1865, the Further Consolidated Appropriations Act, 2010. That Act passed the House (297-120), the Senate (71-23), and was signed by the President on December 20, 2019.

Of special interest to estate planners are certain provision. The Act repeals the provision in the 2017 Tax Act regarding the "Kiddie Tax" applying the income tax rates for trusts to the unearned income of children and allows taxpayers to elect to treat the real as effective for 2018 and 2019. (This has been called the "Gold Star" family provision because the 2017 Kiddie Tax changes had adversely impacted children who received government payments because they are survivors of deceased military personnel and first responders.)

Further, the Act:

- Changes the age that determines the required beginning date (RBD) for minimum distributions (April 1 of the following calendar year) from 70½ to 72, effective for individuals who reach age 70½ after December 31, 2019 (the effect is that no one will have his or her RBD in 2021); (A similar Senate proposal would have extended the required beginning date age to 75 and removed it entirely for pensions worth up to $100,000); and

- Eliminates the prohibition on contributions to an IRA after age 70½ (but the $100,000 limit on qualified charitable distributions from an IRA would be correspondingly reduced [observe that changing the age for required minimum distributions from 70½ to 72 will not change the age at which qualified charitable distributions from IRAs will be permitted]). See Item 3.m. below for a discussion about IRA charitable rollover planning.

- Substantially limits "stretch" planning for distributions from defined contribution plans (and IRAs) following the death of the plan owner (referred to as the "participant"). Under prior law, following the participant's death, plan benefits (including IRA benefits) could be paid over the life expectancy of a "designated beneficiary," to stretch the receipt (and, therefore, the income taxation) of retirement benefits, but the SECURE Act mandates that distributions to a designated beneficiary be made within 10 years following the death of the participant, with exceptions for five categories of "eligible designated beneficiaries." Distributions from the IRA are typically taxed as ordinary income, so the ability to stretch the receipt of those benefits as long as possible defers the time that the income tax must be paid.

(Throughout this discussion of the SECURE Act, references to a "plan" or "plan benefits" will include an IRA.)

B. Post-Death Minimum Distribution Requirements under Prior Law.

A grasp of the prior law minimum distribution requirements following the death of the participant is essential to understand the impact of the changes made by the SECURE Act. Most of this prior law is retained under the SECURE Act (except for the 10-year rule for designated beneficiaries, with special rules for the five categories of eligible designated beneficiaries). The rules are based on regulations proposed in 1987 and 2001 and finalized in 2002, almost 20 years ago. A simplified summary of the prior law follows [provisions impacted by the SECURE Act are briefly noted in italicized comments in brackets.

The treatment varies based on whether or not the beneficiary is a "designated beneficiary" (DB), meaning any individual but not an entity such as the participant's estate, a charity, or a trust that is not a "see-through" trust (described below).

(1) **Beneficiary Not a Designated Beneficiary**. If the beneficiary is not a DB (Non-DB), benefits must be paid within 5 years if the participant died before his or her required beginning date (RBD) or over the participant's remaining life expectancy if the participant died on or after the RBD. [This does not change under the SECURE Act.] The RBD was April 1 of the year after the participant reached age 70½ [changed to age 72 in the SECURE Act].

(2) **Beneficiary is a Designated Beneficiary Other Than a Surviving Spouse**. If the beneficiary is a DB and is not the surviving spouse, the benefits are paid over the DB's life expectancy (if a see-through trust is the beneficiary, over the oldest beneficiary's life expectancy). (If the participant's remaining life expectancy is longer, that period may be used. Reg. §1.401(a)(9)-5, A-5(a)(1).) [The SECURE Act changes this to a maximum 10-year payout instead of the DB's life expectancy; whether the Act changes from allowing the participant's life expectancy if that is longer is unclear if the beneficiary is a DB.]

(3) **Beneficiary is the Surviving Spouse**. If the beneficiary is the participant's surviving spouse, the DB rule described above can apply (that would be applicable, for example, if the beneficiary is a standard QTIP trust that does not mandate that all distributions must pass to the spouse), but even more favorable alternatives may also be elected in some circumstances. If the spouse is the sole beneficiary, the Single Life Table is used, but the life expectancy is recalculated annually. (The specific rules that apply when the spouse is the sole beneficiary are described in more detail in Item 3.c.(4)(i) below.) Better still (in most circumstances), if the spouse chooses to treat the decedent's IRA as his or her own IRA (spousal election) or elects to rollover the decedent's IRA into the spouse's IRA (a spousal rollover), several significant advantages result. (1) Distributions do not need to begin until the spouse reaches his or her RBD. (2) Distributions are made at a slower pace because the Uniform Life Table may be used (which is based on the joint life expectancy of the individual and someone who is 10 years younger). Under the new tables that apply beginning in 2021 (see Item 3.b,(6) below), the life expectancy of a 72-year old person under the

Single Life table is 17.1 years, and under the Uniform Life table is 27.3 years, so using the Uniform Life table allows taking withdrawals from the plan at a substantially slower rate. (3) The surviving spouse can designate his or her own beneficiary, and at the spouse's death, the remaining benefits (which may be much reduced if the spouse has lived to near his or her life expectancy) may be paid over the life expectancy of a DB. [The third advantage is dramatically altered under the SECURE Act.]

(4) **Three Tiers of Beneficiaries**. Natalie Choate summarizes these rules as reflecting three tiers of beneficiaries:

(i) Bronze —Non DBs (5-year rule if participant dies before RBD or the participant's remaining life expectancy if participant dies after RBD) (no change under SECURE];

(ii) Silver — DB (life expectancy payout) [significantly limited under SECURE to 10-year maximum payout for most DBs1; and

(iii) Gold —Surviving spouse (life expectancy with further advantages including delayed starting date, slower payout, and ability to name beneficiary who can receive payout based on the beneficiary's life expectancy) [unchanged under SECURE except that at death of surviving spouse, 10-year rule applies].

(5) **Trust Recipients**. The trust rules described below have not been changed by the SECURE Act (but the importance of which category applies to a particular trust may be impacted dramatically by the SECURE Act.)

(i) **See-Through Trusts**. Although DBs must be individuals, trusts that meet five requirements are classified as "see-through trusts." The individual beneficiaries of a see-through trust are treated as DBs of the plan or IRA (with a special rule as to which such individual's life is used to determine the life expectancy payout period). The five requirements are. (1) the trust must be ~ slid under local law; (2) the trust is irrevocable or becomes so at the participant's death; (3) the beneficiaries are identifiable; (4) certain documentation is provided to the plan administrator; and (5) all trust beneficiaries must be individuals (but "mere potential successor beneficiaries" don't count, which generally means that only the initial remaindermen are counted, not remote successor remaindermen). While the individual beneficiaries are treated as DBs, two special rules do not apply for beneficiaries of a see-through trust —the trust cannot be treated as having separate accounts each having its own beneficiary, and spousal rollovers are not available for any trust, even a see-through trust.

(ii) **Conduit Trusts**. A conduit trust is the nickname (not formally called that in the regulations) of a trust that has one individual beneficiary, and the governing instrument requires that all plan or IRA distributions to the trust must be distributed from the trust to the individual beneficiary. The distributions are deemed paid "to" the individual beneficiary, and the beneficiary is considered the sole beneficiary of the trust and the plan or IRA for minimum distribution purposes, regardless who receives any benefits if the beneficiary should die before all plan assets have been distributed to the trust (and to the beneficiary). A conduit trust is a see-through trust. Conduit trusts are straightforward to draft; they just require that plan distributions to the trust are distributed forthwith to the single beneficiary.

(iii) **Accumulation Trusts**. An accumulation trust is a trust that is not required to distribute all plan benefits as received, but permits the accumulation of distributions within the trust. All beneficiaries (except "mere successor potential beneficiaries") who might ultimately receive such accumulations are considered for purposes of the minimum distribution rules (and the oldest such beneficiary's life expectancy is used as the relevant payout period). These restrictions have led to considerable complexity in drafting accumulation trusts to assure that some older beneficiary or entity might not be a trust recipient, including under the possible exercise of a power of appointment.

(6) **New Life Expectancy Tables for Retirement Plan Required Minimum Distributions**. The Single Life and Uniform Life tables for calculating required minimum distributions are in Reg. §1.401(a)(9)-9(b)-(c). (The Uniform Life table, which is based on the life expectancy of an individual and someone 10 years younger, may be used only while the account owner is living or for a spousal rollover IRA. Otherwise the Single Life (or Joint Lives) Table must be used. The Uniform Life table allows taking withdrawals at a substantially slower rate. For example, the life expectancy of a 72-year old person under the Single Life table is 17.1 years, and under the Uniform Life table is 27.3 years.) Proposed regulations containing revised tables were issued in November 2019. The revised tables will apply to distribution calendar years beginning on or after January 1, 2021. The preamble to the proposed regulations states that the "life expectancy tables and applicable distribution period tables in the proposed regulations reflect longer life expectancies than the tables in the existing regulations that are generally between one and two years longer than under the existing regulations."

C. <u>Post-Death Minimum Distribution Requirements under SECURE Act; Limits on Stretch Planning</u>.

(1) **Overview—Three Tiers of Beneficiaries**. As described before, three tiers of beneficiaries may benefit from retirement plans, but the perks have changed under the SECURE Act.

(i) Bronze —Non DBs (the rules have not changed; 5-year rule if participant dies before RBD or the participant's remaining life expectancy if the participant dies after RBD).

(ii) Silver — DB (downgraded perks; life expectancy payout has been downgraded to payment within 10 years, but apparently the participant's remaining life expectancy can still be used if that is longer, Reg. §1.401(a)(9)-5, A-5(a)(1), although §401(a)(9)(H)(i)(II)'s direction that the 10-year rule for DBs "shall apply whether or not distributions of the employee's interest have begun" might conceivably be interpreted to override that regulation, see Item 3.g. below for further discussion).

(iii) Gold —Favored DBs (this tier has been expanded to five categories rather than just for the surviving spouse; the same rules apply for a surviving spouse except that at the death of the surviving spouse, benefits must be paid within 10 years of the spouse's death; for other EDBs, life expectancy payout as long as the original EDB qualifies as an EDB, but thereafter benefits must be paid within 10 years of when the beneficiary ceases as an EDB).

(2) **Overview of Changes**. The SECURE Act minimum distribution provisions retain the current Code structure as much as possible. These provisions are in Section 401(a) of the ACT (unfortunately, confusingly similar to the Section number of the Code (§401(a)) that contains the rues for qualified retirement plans).

Section 401(a)(9) of the Code contains the provisions about required distributions from qualified retirement plans (including IRAs). The SECURE Act adds a new §401(a)(9)(H), which includes six sub-paragraphs.

- (i) and (ii) — 10-Year Rule for DBs, Except for EDBs. These subparagraphs say, rather obtusely with various cross references, exceptions, and special rules layered over the existing provisions, that if the beneficiary is a DB, the plan assets must be distributed within 10 years of the participant's death unless the beneficiary is an "eligible designated beneficiary" (EDB). A modified life expectancy payout applies as long as the beneficiary is an EDB.

- (iii) —Death of or Otherwise Ceases to be EDB. if an EDB dies or otherwise ceases to be an EDB before the plan has been entirely distributed, the exception for EDBs will no longer apply, but the plan must be distributed within 10 years after such EDB's death or cessation as an EDB (even if the next successor beneficiary is an EDB at that time).

- (iv) and (v) —Special Rule for Trusts for Disabled or Chronically III Beneficiaries. Special rules apply to multi-beneficiary trusts if at least one of the beneficiaries is a disabled or chronically ill individual (these provisions are discussed below); and

- (vi) —Applicable to Defined Contribution Plans, Not Defined Benefit Plans. These rules apply to defined contribution plans (including IRAs and Roth IRAs, but not defined benefit plans, i.e., pension plans).

Section 401(a)(9)(E) is amended to describe five categories of EDBs.

Section 401(b) of the SECURE Act has effective date provisions. The provisions generally apply to plans and IRAs for which the participant dies after 2019, but some effects may result even when participants have died before 2020 (discussed in Item 3.d. below).

Otherwise, all the minimum distribution rules stay the same. The distribution rules have not changed if the beneficiary is not a DB. Determining if a beneficiary is a DB has not changed. The various trust rules (for what is a see-through trust, a conduit trust, or an accumulation trust) have not changed.

(3) **Ten-Year Rule**. The SECURE Act applies its 10-year rule for making distributions to a DB by cross reference to the 5-year rule that applies for non-DBs (if the participant dies before his or her RBD), thus engrafting the body of regulatory law that applies for the 5-year rule. This has the effect of clarifying several issues.

- **Proportionate Distributions Not Required**. Distributions do not have to be made proportionately over the 10-year term; they could be made all in a lump sum at the very end of the term (which would have the effect of deferring recognition of the income, but would also result in "bunching" the income, possibly into a high income tax bracket). For Roth IRAs, deferral until year 10 would likely be the most effective strategy.

- D**ecember 31 Due Date**. Distributions must be made by December 31 of the calendar year that contains the tenth anniversary of the relevant person's death. See Reg. §1.401(a)(9)-3, A-2. (Presumably that same December 31 due date will also apply to the new 10-year rule.)

- **Eleven Calendar Years for Payments**. The actual payout period could extend over 11 taxable years (if death occurs in 2020, the final payment must be made by December 31, 2030, so payments can be made in 2020-2030, or over 11 years). Spreading payments over more years increases the chances that lower tax brackets may apply.

(4) **Eligible Designated Beneficiaries**. The five categories of EDBs are described in new Code Section 401(a)(9)(E)(ii). They are (i) the surviving spouse, (ii) a participant's child who "has not reached majority," (iii) a disabled individual, (iv) a chronically ill individual, and (v) an individual not described above who is not more than 10 years younger than the participant. These beneficiaries qualify for a modified life expectancy payout.

Status as an EDB is determined at the participant's death. A DB who later satisfies one of the five categories of EDBs does not become an EDB for purposes of being able to use an adjusted lifetime payout rather than being subject to the 10-year rule, §401 (a)(9)(E)(ii)(last sentence). (A special rule applies for minors — if the minor is disabled upon reaching majority, the minor exception continues through the period of disability, as discussed in Item 3.c.(4)(ii) below.)

(i) **Surviving Spouse**. To qualify for the spouse exception, the benefits must be payable "to" the surviving spouse, which likely requires that the beneficiary is the surviving spouse outright, or a conduit trust for the surviving spouse (because the conduit trust rules treat the conduit beneficiary as the owner of the trust and plan for purposes of the minimum distribution rules).

Conduit Trust as Beneficiary. If a conduit trust for the spouse is a beneficiary (or if the spouse is the outright beneficiary), the spouse could take advantage of special spousal rules delaying beginning distributions until the end of the year in which the deceased participant would have turned age 72 (§401(a)(9)(B)(iv)(I), as amended by the SECURE Act) and using the Single Life Table but recalculating the life expectancy annually (Reg. §1,401(a1(9)-5, A-5(c)(2) (first sentence, A-6). If the spouse dies before all benefits are paid, the required minimum distribution for the year of death must be paid based on the recalculated life expectancy by the end of the year (if it had not previously been distributed that year), and the balance must be paid within 10 years of the spouse's death. (Before the SECURE Act, the benefits could be paid over the spouse's remaining life expectancy, with no recalculation following his or her death.)

Standard QTIP Trust (Accumulation Trust) as beneficiary. A standard QTIP trust, that does not require that all retirement plan distributions to the trust be distributed to the spouse, would not qualify for this spousal special treatment, even if it is a valid see-though trust, Reg. §1.408-8, A-5(a). Under the SECURE Act, a standard QTIP trust does not qualify as an EDB and the 10-year rule would apply after the participant's death. A QTIP trust, that also required such distributions to the spouse of all plan distributions, would constitute a conduit trust that is an EDB and would qualify for the spousal special treatment.

Spouse as Outright Beneficiary. If the spouse is the outright beneficiary, additional alternatives are available (in addition to the option described above if a conduit trust for the spouse is the beneficiary). The spouse can elect to treat the IRA as his or her own, or may roll over the plan benefits into the spouse's own rollover IRA. Advantages include a delayed starting date (until the surviving spouse reaches age 72) and a slower payout (using the Uniform Life Table). See Item 3,b.(3) above. Under the SECURE Act the spouse would no longer have the ability to name a beneficiary who can receive payout based on the beneficiary's life expectancy, but the remaining benefits would have to be paid by the end of the year in which the tenth anniversary of the spouse's death occurs. If a beneficiary is an EDB at the time of the surviving spouse's death, the EDB rules should apply for that beneficiary (because the spousal rollover IRA is treated as the spouse's IRA, §§408(d)(3)(A), 408 (d)(3)(C)(ii)(II)).

(ii) **Minor Child of Participant**. This exception applies for a minor child of the participant, not a grandchild or any other person's child (such as a niece or nephew).

The exception applies until the child "reaches majority" within the meaning of a specified unrelated provision (an obscure ERISA rule), which has a regulatory provision treating the child as not having reached majority if the child has not "completed a specified course of education" and is under the age of 26. The 10-year rule applies, beginning when the child "reaches majority." Therefore, this exception could possibly extend to age 36. The meaning of a "specified course of education" is unclear.

In addition, if a minor child becomes disabled before reaching majority, the minority status continues as long as the child is disabled. Reg. §1.401(a)(9)-6, A-15.

This exception applies if the minor child is the outright beneficiary or is the beneficiary of a conduit trust (but not an accumulation trust). Whether the exception extends to a conduit trust with multiple "minor children" or to a conduit trust with multiple beneficiaries, only some of whom are "minor children" is unclear even if the trust must be separated into separate conduit trusts for the children at the participant's death. (It is hoped that regulations will provide relief; having four separate conduit trusts for four minor children would make no sense.) Some planners have suggested providing that a conduit trust for a minor child could flip to an accumulation trust after the child reaches majority. However, Natalie Choate believes that the existing trust rules for retirement plan benefits do not clearly sanction that approach.

Query whether a naming a custodian for the minor will be recognized as a transfer to the minor in order to qualify for this exception? If the minor is named outright as the beneficiary of the plan, Section 7(a) of the Uniform Transfers to Minors Act appears to allow the plan to make the distribution to a custodian for the minor.

If a conduit trust is used to qualify for this exception, observe that the withdrawal rate will be very slow using the minor's life expectancy. Under the new Single Life Table, for example, a 15-year old has a life expectancy of 69.9 years, so the initial withdrawals would be about only 1/70th" of the account. The withdrawal would likely be much less than the interest and dividend produced by the account, and the account would likely continue to grow during the period the minor qualified for EDB treatment. After the minor "reaches majority," further withdrawals from the account could be halted for 10 years, at which time the entire account would be withdrawn. That could possibly last until the "minor" child is 36 years old before most of the account balance would have to be distributed from the account to the trust and from the trust to the beneficiary.

What happens if more minor children are born to the participant after the participant's death is unclear, but the statute says that the determination of whether a DB is an EDB "shall be made as of the date of death of the employee."

Few parents die while a child of the parent still a minor, and even rarer it is for both parents to die with a minor child, Participants with minor children often do not yet have significant retirement benefits. Benefits may have to be withdrawn within 10 years of the participant's death to pay college expenses in any event. Accordingly, instead, young parents should consider making sure they have a sufficient amount of term insurance (relatively cheap for young adults) to provide for their minor children.

(iii)-(iv) **Disabled or Chronically Ill Individuals**. The most helpful of the five categories of EDBs is that a modified life expectancy payout applies if the DB is disabled or chronically ill, thus providing favorable treatment for special needs trusts. The SECURE Act provides cross references to definitions of disabled or chronically ill individuals. For example, a person who qualifies for Social Security disability benefits qualifies for this exception.

The beneficiary's status as an EDB is determined at the participant's death. §401(a)(9)(E)(ii)(last sentence). If a DB later becomes an EDB (i.e., is later disabled) before all distributions have been made from the plan, the plan cannot switch to EDB status.

A special provision under §401(a)(9)(H)(v) for multi-beneficiary trusts for disabled and chronically ill beneficiaries gives these two categories of EDBs benefits not enjoyed by other EDBs: (i) A mandated division at the participant's death is given effect, contrary to the result described for retirement plan distributions generally in Reg. §1.401(a)(9)-4, A-5(c) (for example if some of a single pot trust is divided into a separate trust for a disabled or chronically ill child, that separate trust would qualify for this exception); (ii) A single trust with multiple disabled or chronically ill individuals as beneficiaries qualifies for the exception; and (ii) An accumulation trust for disabled or chronically ill beneficiaries qualifies for the exception (whose life expectancy is used in that case is not clear, and the conservative approach, until the IRS gives further guidance, is to have remainder beneficiaries who are no older than the disabled or chronically ill current beneficiary or beneficiaries).

Being able to use accumulation trusts is particularly helpful for special needs trust planning. See Item 33 regarding special needs trust planning generally. Further IRS guidance is needed with respect to various issues for special needs trusts, including when and how the determination of whether a beneficiary is disabled or chronically ill must be made. As examples of the need for further guidance, many special needs trusts include a "backstop provision" allowing distributions to other beneficiaries of amounts that would cause the disabled beneficiary not to qualify for government assistance programs or include a provision allowing distributions to other beneficiaries for tax planning in light of the high rates applied to undistributed trust income. How will those provisions impact qualification of a trust as an EDB in light of its disabled or chronically ill beneficiaries? Until further guidance is provided, consider revising special needs trusts to exclude (i) backstop provisions, (ii) provisions allowing excess assets to be distributed to non-disabled beneficiaries, or (iii) provisions allowing the payment of travel expenses of a travel companion for a disabled beneficiary.

The April 2020 issue of Trusts and Estates magazine includes an article by Nancy Welber about use of the disabled and chronically ill beneficiary exceptions in the SECURE Act.

(v) **Less-Than-10-Years Younger Beneficiary**. A classic example for this exception would be siblings of the participant who are older than the participant or not more than 10 years younger than the participant. Distributions made outright or to a conduit trust for such a beneficiary will qualify for this exception. Different siblings may be treated quite differently. Distributions to a sibling who is 9 years and 364 days younger than the owner would qualify for the lifetime payout but distributions to a sibling who is 10 years and 1 day younger would have to be paid within 10 years.

(5) **Death of DB**. At the death of a DB who is not an EDB (someone Natalie Choate refers to as a PODB, or "plain of designated beneficiary"), the benefits must still be paid out within the ORIGINAL 10-year period (actually by December 31 of the 10^{tH} year) after the participant's death.

When an EDB ceases to be an EDB, the benefits must be paid within 10 years of THAT time and not over the EDB's remaining life expectancy (for example, 10 years following the death of a surviving spouse or beneficiary not more than 10 years younger than the participant). §401(a)(9)(E)(iii).

When the EDB ceases to qualify as an EDB (due to death or any other reason), whether the successor beneficiary would qualify as an EDB at that time does not matter—the 10-year rule applies when the original EDB is no longer an EDB.

D. Application of SECURE Act to Pre-2020 Deaths.

The anti-stretch provisions of the SECURE Act generally apply to participants who die after 2019, EXCEPT that if the initial DB dies after 2019 and before the plan assets have been totally distributed, the remaining benefits must be paid within 10 years of when such DB dies (even though the participant died before 2020). (Under prior law, when the DB died, the DB's beneficiary could continue to receive benefits over the DB's remaining life expectancy.)

For a discussion of disclaimer planning for pre-2020 deaths, see Item 3.i.(2) below.

The effective date provisions are unclear about what happens if the participant had multiple DBs.

E. General Client Triage Approach.

The anti-stretch provisions of the SECURE Act are interesting in that they constitute a major broad tax change, but they affect everybody differently based on specific client situations and goals.

(1) **Little or No Impact**. Many people will not be affected at all.

- Many clients and their families have small enough plans and assets outside of plans that deferring the receipt of money otherwise available for living expenses is the least of their concerns.

- Most retirement plan beneficiaries are not making plan withdrawals only at the minimum rate permitted. The preamble to the proposed regulations containing the new life expectancy tables for determining life payout rates from retirement plans indicates that only about 20°/o of individuals required to take RMDs make withdrawals at the minimum required level. Most (or at least a substantial portion) of the remaining 80% of plan beneficiaries will not be affected by the SECURE Act's 10-year yule.

- For married couples, naming the surviving spouse as the outright beneficiary of the retirement plan is the most common arrangement. The same rules apply for the surviving spouse as in the past (except that the 10-year rule will apply as to any benefits still in the plan at the spouse's subsequent death, but the likelihood that substantial assets will remain in the plan after making life payments to the surviving spouse may be relatively small).

- If the participant has no surviving spouse, clients with substantial assets in retirement plans are likely to have adult (rather than minor) children and many individuals name their adult children as the outright beneficiaries of the plan assets following the deaths of both spouses (favoring simplicity over the benefits of trusts for receiving retirement benefits).

- A charity may be named as beneficiary, in which event the SECURE Act has no impact.

(2) **Emergency Impact**. For some clients, immediate emergency action is required. Individuals who have wanted to maximize the stretch planning may be using plans to stretch the receipt of taxable benefits over the life expectancies of young children or grandchildren. Those plans often entail naming a conduit trust for the young beneficiary, leaving the trustee and not the young recipient with the power to decide whether large withdrawals would be made from the plan (or IRA). The individual likely anticipated that relatively small annual distributions would be made to the trust (and distributed from the trust to the beneficiary) annually. Instead, under this planning scenario the entire plan value will be distributed within 10 years and distributed from the trust to the beneficiary (unless the beneficiary is an EDB). Natalie Choate's conclusion: "Almost invariably, conduit trusts will not work the way the client anticipated or wants."

(3) **Slight Tweaks** Needed. For some clients, relatively minor tweaks may be needed in light of the SECURE Act. For example, an individual might tweak the type of QTIP trust that is used for a surviving spouse. A classic QTIP trust (that does not mandate that all retirement plan distributions be distributed immediately to the surviving spouse) qualified for payout over the spouse's life expectancy under the old rules but would be subject to the 10-year payout requirement under the SECURE Act. An individual might prefer to tweak that plan to require the distribution to the spouse of all amounts received from the plan so that the QTIP trust would be a conduit trust and qualify for payments over the spouse's life expectancy (Single Life Table, recalculated annually).

Having broad distribution standards with an independent trustee in accumulation trusts may be helpful to provide more income-shifting flexibilities by making trust distributions (because almost all undistributed trust income is taxed at the highest marginal bracket).

If disabled or chronically ill persons are plan beneficiaries, tweaks may be needed to special needs trusts for them. For example, accumulation trusts may qualify for special treatment, without the need for conduit trust provisions.

F. <u>Conduit Trusts</u>.

The use of a conduit trust as the beneficiary is especially sensitive under the SECURE Act.

(1) **Conduit Trusts Needed for Certain EDBs**. In some situations, using conduit trusts will be very important if a client wants to u ;e a trust for a beneficiary —for example to qualify for EDB treatment (and a modified life payout) for a surviving spouse, a minor child of the participant, or someone not more than 10 years younger than the participant. (Accumulation trusts can be used for disabled or chronically ill individuals and still qualify for EDB treatment.)

If a conduit trust is used for a minor child of the participant, the planner should take into consideration that the entire account will have to be distributed outright to the child at the latest ten years after the child "reaches majority." The planner should weigh:

> the advantage of employing an extremely slow withdrawal from the account until the child reaches the age of majority (because of the minor's 60- to 80-year life expectancy), with no further withdrawals for another ten years; against
>
> the disadvantage that at the end of that period (which could be a much extended period for a very young child), the entire account will have to be distributed outright to the child without any further trust protection.

(2) **Conduit Trusts Will Not Generally Be Used in Other Situations; Can be Disastrous in Some Situations**. In other situations, using conduit trusts may be **disastrous**. For example, if the client wanted to have benefits paid over the life of a young child, the client likely wanted to use a trust for the young beneficiary for management purposes. Conduit trusts were much simpler than accumulation trusts in the past because subsequent beneficiaries and permissible appointees are not relevant for purposes of determining the relevant life expectancy payout period. Conduit trusts have often been used in the past because of their relative simplicity. (For example, if an accumulation trust were used and if the contingent beneficiary were older than the young beneficiary, the contingent beneficiary's life expectancy would have been used rather than that of the young beneficiary.) Under the SECURE Act all plan benefits must be paid within 10 years, and with a conduit trust, those benefits are paid immediately to the beneficiary. Therefore, the deferral advantage of using a very young beneficiary is largely lost (benefits must be distributed within 10 years regardless of the beneficiary's age), and all of the nontax benefits of trusts (including preserving assets, protecting from a beneficiary's squandering of the assets, and protecting from creditors) will be available for only up to 10 years. Using a conduit trust as the plan beneficiary for an individual beneficiary who is a spendthrift could lead to the individual's squandering funds after the plan and trust distribute all plan assets to the individual within 10 years.

Again, Natalie's axiom applies: "**Almost invariably, conduit trusts will not work the way the client anticipated or wants**." But conduit trusts can be helpful if they result in EDB treatment for the beneficiary with a payout over the beneficiary's life expectancy until the EDB status ends.

Locating and identifying clients with conduits trusts will be challenging, Firms do not keep track of clients who are using conduit trusts as plan beneficiaries. Contacting past clients with a message to contact the attorney if the client has a "conduit trust" will not work because most clients have no idea what a conduit trust is. (Furthermore, Natalie quips, "clients never read anything you send them anyway.")

G. <u>Accumulation Trusts Will Become More Common</u>.

In most cases going forward (other than needing to qualify for EDB treatment for spouses, minor children, or beneficiaries not more than 10 years younger than the participant), plan benefits that are being paid to trusts will pass to accumulation trusts. The complexity of structuring accumulation trusts in the past is no longer applicable because the life expectancies of the primary beneficiary and successor beneficiaries are no longer relevant —plan benefits must be distributed within 10 years regardless. Presumably regulations will eventually clarify that the oldest potential beneficiary or appointee under a power of appointment does not have to be identifiable. Excluding beneficiaries who are older than some specified age will no longer be necessary.

The only requirement, for the trust to be a designated beneficiary, is that non-human beneficiaries are excluded as potential beneficiaries. (If the accumulation trust is not a designated beneficiary, the traditional non-DB rules apply.)

Going forward, accumulation trusts subject to the 10-year rule perhaps can be simpler —merely excluding any non-humans as potential beneficiaries (other than as "mere successor potential beneficiaries") or as possible appointees under a power of appointment. However, planners may want to hold off on simplifying provisions in accumulation trusts designed to limit who might be the oldest potential beneficiaries until we get further guidance from the IRS. Natalie Choate points out that a see-through trust must meet four requirements (see Item 3.b.(5)(i) above), one of which is that the beneficiaries must be "identifiable," and for members of a class, that means being able to identify "the class member with the shortest life expectancy." Reg. §1.401(x)(9)-4, A-1. Knowing the shortest life expectancy no longer matters for accumulation trusts subject to the 10-year rule, but until the regulation has been updated, the conservative approach is to utilize the limits we have used in the past regarding the oldest potential beneficiary.

Furthermore, when accumulation trusts are used for disabled or chronically ill persons, a life expectancy payout applies, and if a person older than the disabled or chronically ill person is a remainder beneficiary (other than a mere potential successor beneficiary), that older person's shorter life expectancy might be used for determining the payout period. See Item 3.c.(4)(iii)-(iv) above. For example, the trust might provide that if the trust has a disabled or chronically ill person as beneficiary, within the meaning of §401(a)(9)(E)(i), no portion of the trust for that person shall ever pass under the terms of the trust or under the exercise of any power of appointment to any person who is older than the beneficiary.

Consider giving a "trust protector" the authority to revise the terms of the accumulation trust by the September 30 "finalization date" of the year of the owner's death (discussed in Item 3.i.(2) below) to eliminate unneeded restrictions in accumulation trusts based on IRS guidance available at that time.

To be or not to be a DB? Planning for an accumulation trust **to be a DB** would be important if the participant dies before his or her RBD (April 1 of the year after reaching age 72 under the SECURE Act) to use a 10-year rather than a 5-year payout, and if the participant dies after the RBD when he or she is over about age 81 and thus having a life expectancy of less than 10 years. (Under the new life expectancy retirement plan Single Life Table issued in November 2019 and that will apply beginning in 2021, an 81-year person has a life expectancy of 10.5 years.) On the other hand, if the participant dies after the RBD when he or she is 81 years or younger, the participant's remaining life expectancy is greater than 10 years, and using the non-DB payout rules would result in a longer payout than under the DB rules.

Conceivably, the trust could be planned **NOT to be a DB in that circumstance** (by having an entity (for example, a charity) as a discretionary beneficiary, as a successor beneficiary, or as a potential appointee under a power of appointment) in order to use the participant's remaining life expectancy, which would be longer than the 10-year rule that applies for a DB beneficiary.

- Observe, though, that the trust may qualify for the longer payout using the participant's remaining life expectancy even if the trust is a DB because the regulations allow using the longer of the DB's life expectancy or the participant's remaining life expectancy at the RBD. Reg. §1.401(a)(9)-5, A- 5(a)(1).

- However, §401(a)(9)(H)(i)(II)`s direction that the 10-year rule for DBs "shall apply whether or not distributions of the employee's interest have begun" might conceivably be interpreted to override that regulation if the trust is a DB.

- But the "longer of" position in the regulations seems contrary to the "at-least-as- rapidly" statutory requirement that has long existed in §401(a)(9)(B)(i), so perhaps the IRS's "longer of" position in the regulations will continue despite the new statutory language saying that the 10-year rule "shall apply" for DB's "whether or not distributions of the employee's interests have begun."

Also, Nancy Welber has pointed out that the maximum participant remaining life expectancy, if the participant dies after his or her RBD (April 1 of the year after reaching age 72) is 16.3, and that payments would not begin until the following year, when the payout period would be 15.3 years. Natalie Choate suggests that future regulations might take the sensible approach of allowing the trust to use the longer payout in that circumstance even if it is a DB.

H. <u>Rethinking Beneficiary Planning —Brief Summary</u>.

(1) **Favor Simplicity; Example —Outright to Children**. A participant may prefer the simplicity of leaving plan benefits directly to children, rather than having the benefits paid to trusts for grandchildren (ostensibly to have benefits paid over their long life expectancies), since the benefits must be paid within 10 years in any event.

(2) **Combo Approach**. Melissa Willms (Houston, Texas) suggests that in some cases a combo approach might be appropriate. A portion may go outright to a child (among other things, to take advantage of the child's lower income tax brackets), and a portion might go in trust for the child (for the nontax advantages of trusts). Or one child's portion may be outright and another child's portion may be in trust.

(3) **Consider Income Tax Effects**. Estate planning focuses a great deal on the 40% estate tax, but keep in mind that the income tax is also almost 40%, and trusts reach the top bracket after only $12,950 of taxable income. Even if trusts would be helpful for nontax purposes (such as creditor protection, especially if the beneficiary's state does not recognize a creditor exemption for IRA benefits), consider that the trust may pay a 37% income tax whereas individual beneficiaries may be in much lower brackets. (This is also a consideration for what distributions can and should be made out of trusts for income shifting purposes.) If a trust is being used primarily for creditor protection, consider whether the creditor protection is worth the potential income tax cost, and whether that protection might be better afforded by other means (such as an umbrella liability policy where it covers the major creditor risk).

(4) **Conduit Trusts**, Any individuals using conduit trusts should review the plan and confirm that it is still appropriate under the SECURE Act, understanding that all plan benefits would be paid to the beneficiary within 10 years of the participant's death unless the beneficiary is an EDB, in which event a conduit trust may be required for EDB treatment to use an adjusted life payout for a surviving spouse, minor child (until reaching majority), or person not more than 10 years younger than the participant. For a minor child, the planner should not knee-jerk into using a conduit trust, but should weigh the advantage of the added period of deferral against the fact that all of the account would be distributed to the child within 10 years of reaching majority.

(5) **Accumulation Trusts**. In most cases going forward, plan benefits that are paid to trusts will pass to accumulation trusts (again, unless the trust primary beneficiary is an EDB). The terms of accumulation trusts can be simplified to delete complicated restrictions (for example to assure that no older beneficiaries are possible under the trust). Accumulation trusts going forward must merely prohibit any non-individuals as permissible beneficiaries. For example, Mickey Davis (Houston, Texas) indicates that unless future regulations provide otherwise, his trust forms for trusts designed to accept retirement plan benefits as an accumulation trust will remove references to age and life expectancies of beneficiaries and wily provide in essence, "if I die before my RBD, or after my RBD when my life expectancy is less than 10 years, this trust will not have any entities as beneficiaries or permissible appointees." An alternative is giving a "trust protector" the authority to revise the terms of the accumulation trust by

the September 30 "finalization date" of the year of the owner's death (discussed in Item 3.i.(2) below) to eliminate unneeded restrictions in accumulation trusts based on IRS guidance available at that time.

IRS guidance eventually may clarify that the trust does not have to include provisions making it a non-DB to take advantage of a possible slightly longer payout that might be permitted for non-DBs, in case the participant dies after the RBD and has a remaining life expectancy longer than 10 years. See Item 3.g. above. Having broad distribution standards with an independent trustee in accumulation trusts may be helpful to provide more income-shifting flexibilities by making trust distributions (because almost all undistributed trust income is taxed at the highest marginal bracket).

(6) **Disproportionate Allocation of Benefits to EDBs, Particularly Lower Bracket EDBs**. A plan or IRA owner might leave plan benefits disproportionately to a disabled beneficiary or a sibling with modest income, and leave other non-taxable assets to other beneficiaries in high income tax brackets.

(7) **Charity**. The only way to beat having to pay income tax on retirement benefits is to leave the benefits to charity. The charity is a tax-exempt entity and pays no income on receiving the benefits. Alternatively, a charitable remainder trust could be used to avoid paying income tax on receipt of the plan benefits and payments could be made to an individual beneficiary for life, but a significant enough value is left to the charity that the participant must have some charitable intent for this arrangement to make sense. See Item 3.j.(2) below.

I. <u>Post-Mortem Fixes and Considerations After Participant's Death</u>.

If appropriate adjustments have not been made before the participant's death, several alternatives exist for making post-mortem adjustments to the plan beneficiaries.

(1) **Post-Mortem Reformation**. Despite the IRS's position in PLR 200742026 that it would no longer consider post-death reformations of retirement plan beneficiary designations, Natalie Choate believes that the IRS will accept a reformation if it reflects a reasonable settlement of a bona fide contest or controversy ("but family members have to genuinely hate each other for this to work," Natalie says). In addition, many PLRs have accepted reformations to correct scrivener errors. A lot of reformation proceedings may occur in the future in light of the huge law change for retirement plan minimum distributions under the SECURE Act, but planners cannot just ignore the SECURE Act thinking that they can fix any problems with a postmortem reformation.

(2) **"Clean Up" Before September 30 Finalization Date**. The beneficiaries who are counted in determining the DBs of the plan are "the beneficiaries designated as of the date of death who remain beneficiaries on September 30 of the calendar year following the calendar year of the [participant's] death." Reg. §1.401(a)(9)-4, A-4(a). If certain beneficiaries of a trust would not constitute DBs, they could be removed as beneficiaries prior to the September 30 "finalization date" (1) by making full distribution to that beneficiary of its interest in the plan, or (2) by the beneficiary's disclaimer of the plan benefits.

As an example of possible disclaimer planning, if a participant died before 2020 leaving the surviving spouse as the beneficiary, the benefits can be paid over the spouse's life expectancy under favorable rules (using the Uniform Table with a spousal rollover, etc.). At the surviving spouse's subsequent death, however, the 10-year rule will apply and all remaining benefits must be paid within 10 years of the spouse's death. Alternatively, the spouse could disclaim and if the effect of the disclaimer is that the benefits would pass to young beneficiaries (or to a trust using a young beneficiary's life expectancy to determine the payout period), the benefits could be paid over the life expectancy of such young beneficiary (possibly over 50-70 years). (If the participant had not received the annual distribution in the year of death, the RMD must be taken by the beneficiary for the year of death. The IRS has ruled that it will not treat the acceptance of that RMD for the year of death as acceptance of plan benefits that would preclude a valid disclaimer of the rest of the plan benefits. Rev. Rul. 2005-36.)

(3) **Consider When to Take Withdrawal**. Another important post-mortem consideration is when to take the withdrawal from the plan or IRA. It must be taken by the end of the 10^{th} year (if the plan has a designated beneficiary who is not an EDB). If the benefits are withdrawn soon after the participant's death, the benefits will be taxed at ordinary income rates, all at once, BUT the future growth possibly could be taxed at capital gains rates long in the future (or some could be tax-free if the fixed income portion of the portfolio is invested in municipal bonds). What average growth rate would be required from the investments over the next 10 years for the income taxes savings on capital gain rates (plus the 3.8% tax on net investment income) vs. ordinary rates on the growth to overcome the lost time value of the ordinary income tax being paid upfront by the time you get to the end of the 10-year period? Or could lower income tax rates be applied if the amount is withdrawn from the plan over a number of years in the first ten years (really 11 taxable years, as mentioned in Item 3.c.(3) above)?

We should be able to calculate what the growth rate of the investments would need to be, over the next 10 years, for the taxes savings on capital gain vs ordinary rates on the growth to overcome the lost time value of the ordinary income tax being paid up front by the time you get to the end of the 10-year period.

J. Charitable Planning.

A charity is a good beneficiary of a retirement plan, because the plan benefits are taxed as ordinary income on receipt by an individual, but a charitable beneficiary is tax-exempt and pays no income tax.

(1) **Mechanics of Naming Charity as Beneficiary**. The preferable way to name a charity as beneficiary of a retirement plan or IRA is to name a donor advised fund of an institutional provider. If a charity is named directly, some IRA providers require massive amounts of information regarding the charity and all of its directors to comply with the KYC rules under the Patriot Act. Communities foundations or other institutions sponsoring DAFs are familiar with complying with those rules.

(2) **Charitable Remainder Trust or Charitable Gift Annuity**. A charitable remainder trust (CRT) makes annual annuity or unitrust payments to an individual for the individual's life expectancy or for a term of years (up to a maximum of 20 years). The trust must be structured so that the value of the charitable remainder interest

is worth at least 10% of the value contributed to the trust. The IRS has published a sample CRT form. Natalie strongly suggests using the IRS sample form, with a few tweaks suggested in LEIMBERG CHARITABLE PLANNING NEWSLETTERS #80 (by Larry Katzenstein) and #88 (by Richard Fox) in 2006.

The plan benefits could be paid to the CRT immediately following the participant's death, thus satisfying the RMD requirements for the plan. The CRT is a tax-exempt entity, and does not pay income tax on receipt of the plan benefits.

When distributions are made to the individual beneficiary, a "tier system" applies to carry out the income tax attributes of the CRT's assets to the individual beneficiary. Ordinary income is deemed distributed first. As payments are made over the life of the beneficiary, all or almost all of the amounts paid to the individual likely will represent the plan benefits and will be taxed as ordinary income.

The use of the CRT is not primarily a way to beat the SECURE Act and save income taxes.

An article by Prof. Christopher Hoyt in the April 2020 issue of Trusts and Estates magazine explores the use of CRTs under the SECURE Act.

For a discussion of an alternate arrangement of leaving an IRA to charity for a gift annuity, see Katzenstein, Testamentary Gift Annuities as Alternative to a "Stretch" Charitable Remainder Trust?, LEIMBERG CHARITABLE PLANNING NEWSLETTERS #292 (Feb. 10, 2020) (advantages of charitable gift annuity over CRT include possible better income tax treatment, no need of having a separate trust and trustee, and the annuity can be deferred, graduated, or "flexible" by having a deferred annuity and allowing the annuitant to choose to delay the start date, but with a commensurate increase in the annuity amount).

K. <u>Roth IRAs</u>.

The 10-year rule anti-stretch provisions in the SECURE Act apply to Roth IRAs. The accelerated payments from the Roth IRA following the owner's death would not bear a 37% immediate tax, but the opportunity for future tax-free buildup over a long period of time would be lost.

Roth conversions may still make sense for taxpayers who are in considerably lower income tax brackets (due to lower income, NOLs, loss carryovers, etc.) than the beneficiaries. (If an accumulation trust is the beneficiary, the trust reaches the maximum 37% bracket at a mere $12,950 of taxable income in 2020, so the participant might be in a significantly lower bracket. However, the time period for the tax-free growth would generally be limited to 10 years following the person's death because of the 10-year rule.)

L. <u>Trusteed IRAs</u>.

The SECURE Act applies to trusteed IRAs the same as custodial IRAs. The only difference is that the plan provider is a fiduciary who has responsibility for investment and distribution decisions rather than just serving as custodian of the IRA. A distinction is that trusteed IRAs are often marketed as a way of getting stretch payouts without the client's having to prepare a separate complicated trust agreement. The nontax advantages of the trusteed IRA arrangement still exist, but not the stretch purpose (except for EDBs).

M. IRA Charitable Rollover.

The SECURE Act does not eliminate the IRA charitable rollover, but the $100,000 limit on qualified charitable distributions from an IRA that can be excluded from income will be correspondingly reduced by any contributions to IRAs after a person has reached age 72. Changing the age for required minimum distributions from 70½ to 72 will not change the age at which qualified charitable distributions from IRAs will be permitted.

Particularly for non-itemizers, donors over age 70½ should consider making their charitable donations with IRA charitable rollovers at least up to the amount of the minimum required distribution and up to a maximum of $100,000 per year. Even though the non-itemizer donor does not get an income tax deduction, the donor will avoid recognizing income on the distributions. Especially if the donor has reached the RBD (April 1 of the year after reaching age 72 if the person had not reached age 70½ in 2019), the donor will avoid recognizing income on the required distributions, from the IRA.

(1) **Reporting**. Box 1 of Form 1099-R from the '!~A custodian will show the total amount of distributions from the IRA. The Form 1099-R does not reflect which of the distributions are "qualified charitable distributions." The taxpayer reports the full distribution amount on line 4a of Form 1040, and reports the taxable distributions (for example, the amount that is not a qualified charitable distribution) on line 4b of Form 1040, and should enter "QCD" next to line 4b. The qualified charitable distribution amount cannot be deducted and will not be entered on Lines 11 or 12, Schedule A of Form 1040.

(2) **Cannot Use Donor Advised Fund**. An IRA qualified charitable distribution cannot be made to a donor advised fund (or to a supporting organization or private foundation).

N. Waiver of 2020 Required Minimum Distributions, Notice 2020-5.

The Notice states:

> This notice provides guidance relating to the waiver of 2020 required minimum distributions, described in § 401(a)(9) of the Internal Revenue Code (Code), from certain retirement plans under section 2203 of the Coronavirus Aid, Relief, and Economic Security (CARES) Act, Pub.L. 116-136, 134 Stat. 281 (2020). In particular, the notice:
>
> - permits rollovers of waived required minimum distributions (RMDs) and certain related payments, including an extension of the 60-day rollover period for certain distributions to August 31, 2020;
>
> - answers questions relating to the waiver of 2020 RMDs; and

- provides a sample plan amendment that, if adopted, would provide participants a choice whether to receive waived RMDs and certain related payments.

The notice also provides transition relief for plan administrators and payors in connection with the change in required beginning date for RMDs under § 401(a)(9) of the Code pursuant to section 114 of the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act), enacted on December 20, 2019, as Division O of the Further Consolidated Appropriations Act of 2019, Pub. L. 116-94, 133 Stat. 2534 (2019).

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A. Payor and plan administrator guidance related to SECURE Act change to required beginning date. A distribution from a plan made during 2020 to a participant who will attain age 70½ in 2020 that would have been an RMD but for the change in the required beginning date under section 114 of the SECURE Act is not required to be treated as an eligible rollover distribution for purposes of §§ 401(a)(31), 402(f), and 3405(c). Thus, for example, if a participant who attains age 70½ in 2020 received a distribution in January 2020, and part of the distribution was not treated as an eligible rollover distribution because it was improperly characterized as an RMD, then, pursuant to the relief in this paragraph III.A, the payor and plan administrator will not be considered as having failed to satisfy the requirements of §§ 401(a)(31), 402(f) and 3405(c) merely because of that treatment.

B. Rollover guidance for plan participants. Consistent with the legislative intent with respect to section 2203 of the CARES Act to permit taxpayers to avoid taking RMDs in 2020, the Department of the Treasury (Treasury Department) and the IRS are providing relief to allow taxpayers who receive certain distributions to roll them into an eligible retirement plan (even if the distribution normally would be treated as part of a series of substantially equal periodic payments). Specifically, the following distributions from a plan (other than a defined benefit plan) may be rolled over, provided the other rules of § 402(c) are satisfied (and regardless of whether the distributions would otherwise be made as part of a series of substantially equal periodic payments):

> 1. distributions to a plan participant paid in 2020 (or paid in 2021 for the 2020 calendar year in the case of an employee who has a required beginning date of April 1, 2021) if the payments equal the amounts that would have been RMDs in 2020 (or for 2020), but for section 2203 of the CARES Act (2020 RMDs), or are one or more payments (that include the 2020 RMDs) in a series of substantially equal periodic payments made at least annually and expected to last for the life (or life expectancy) of the participant, the joint lives (or joint life expectancies) of the participant and the participant's designated beneficiary, or for a period of at least 10 years; and
>
> 2. for a plan participant with a required beginning date of April 1, 2021, distributions that are paid in 2021 that would have been an RMD for 2021 but for section 2203 of the CARES Act (as described in Q&A-5 of section V of this notice).

C. Extension of 60-day deadline for rollover of certain distributions. To assist plan participants who have already received distributions in 2020, the Treasury

Department and the IRS, pursuant to § 402(c)(3)(B), are extending the 60-day rollover period for any payments described in section III.A and section III.B of this notice so that the deadline for rolling over such a payment will not be before August 31, 2020. For example, if a participant received a single-sum distribution in January 2020, part of which was treated as ineligible for rollover because it was considered an RMD, that participant will have until August 31, 2020, to roll over that part of the distribution. In addition, the Treasury Department and the IRS, pursuant to § 408(d)(3)(I), are extending the 60-day rollover period for IRA distributions in 2020 that would have been an RMD in 2020 but for section 2203 of the CARES Act or section 114 of the SECURE Act, so that the deadline for rolling over such distributions will not be before August 31, 2020.

D. Permitted repayments of RMDs previously distributed from an IRA. In the case of an IRA owner or beneficiary who has already received a distribution of an amount that would have been an RMD in 2020 but for section 2203 of the CARES Act or section 114 of the SECURE Act, the recipient may repay the distribution to the distributing IRA, even if the repayment is made more than 60 days after the distribution, provided the repayment is made no later than August 31, 2020. The repayment will be treated as a rollover for purposes of § 408(d)(3) of the Code, but will not be treated as a rollover for purposes of the one rollover per 12-month period limitation in § 408(d)(3)(B) and the restriction on rollovers for nonspousal beneficiaries in § 408(d)(3)(C).

PART 3 – ESTATE PLANNING PRACTICE IN 2018 AND BEYOND

I. WHERE WE ARE TODAY

A. New Planning Approaches

1. Given the large Applicable Exclusion Amount, it becomes clear that for many even traditional clients the estate tax has disappeared as an issue. This could change depending on political developments and is to change anyway on January 1, 2026; many clients are under $24 million but above $12 million.

2. As 2026 approaches, absent change, we will be faced with enormous pressure to enable clients to make gifts to use the soon to exercise basis exemption amount. Laying the groundwork today for such a possibility seems wise.

3. Estate planners will focus more of the tax planning for clients on the income tax, rather than the transfer taxes. In particular, it is likely estate planning will focus on tax basis planning and maximizing the "step-up" in basis at death.

4. Because the "step-up" in basis may come at little or no transfer tax cost, estate planners will seek to force estate tax inclusion in the future.

5. The state of residence of the client and his or her beneficiaries will greatly affect the estate plan. In other words, if a client is domiciled in California, and his or her beneficiaries living in California, then dying with the assets may be the extent of the tax planning. On the other hand, if the beneficiaries live in a state like Texas that has no state income tax, then transferring the assets out of the estate during the lifetime of the client may be

warranted. As a result, estate planners will need to ask clients two questions that, in the past, did not significantly matter: (a) Where are you likely to be domiciled at your death? and (b) Naturally, at your death, your children, grandchildren, and other beneficiaries will be lovingly at your bedside, but where are they likely to be domiciled then?

B. Portability Planning

1. Portability, at least in theory, can provide additional capacity for the surviving spouse's estate to benefit from a "step-up" in basis with little or no transfer tax costs. The extent to which portability is being used is uncertain. The 2017 IRS statistical data showed only 681 nontaxable portability returns filed.

2. In traditional by-pass trust planning, upon the death an individual who has a surviving spouse, assets of the estate equal in value to the decedent's unused Applicable Exclusion Amount fund a trust (typically for the benefit of the surviving spouse and, perhaps, descendants). The trust is structured to avoid estate tax inclusion at the surviving spouse's estate. The marital deduction portion is funded with any assets in excess of the unused Applicable Exclusion Amount. The by-pass trust avoids estate tax inclusion at the surviving spouse's estate. From an income tax standpoint, however, the assets in the by-pass trust do not receive a "step-up" in basis upon the death of the surviving spouse. Furthermore, while the assets remain in the by-pass trust, any undistributed taxable income above minimal amounts will be subject to the highest income tax rates at the trust level.

3. In portability planning, the decedent's estate would typically pass to the surviving spouse under the marital deduction, and the DSUE Amount would be added to the surviving spouse's Applicable Exclusion Amount. Because all of the assets passing from the decedent to the surviving spouse in addition to the spouse's own asset will be subject to estate taxes at his or her death, the assets will receive a "step-up" in basis. Additional income tax benefits might be achieved if the assets that would otherwise have funded the by-pass trust are taxed to the surviving spouse, possibly benefiting from being taxed a lower marginal income tax bracket. In addition, if the by-pass trust would have been subject to a high state income tax burden, having the assets taxed to a surviving spouse who moves to a low or no income tax state would provide additional income tax savings over traditional by-pass trust planning.

4. Of course, there are other considerations, including creditor protection, "next spouse" issues and potential "Medicaid" planning, which would favor by-pass trust planning. From a tax standpoint, the trade-off is the potential estate tax savings of traditional by-pass trust planning against the potential income tax savings of portability planning. Because the DSUE Amount does not grow with the cost-of-living index, very large estates will benefit more with traditional by-pass trust planning because all of the assets, including any appreciation after the decedent's death, will pass free of transfer taxes. On the other hand, smaller but still significant estates should consider portability as an option because the combined exclusions -- the DSUE Amount frozen but the surviving spouse's Applicable Exclusion Amount growing with the cost-of-living index -- is likely to allow the assets to pass at the surviving spouse's death with a full step-up in basis with little or no transfer tax costs (unless the assets are subject to significant state death taxes at that time).

Estates where a surviving spouse may need to qualify for government assistance should consider a modified by-pass trust type planning; the trust for the surviving spouse is designed specifically with governmental assistance in mind. For example, perhaps a child or other person should be allowed to terminate the spouse's interest in the trust (or otherwise modify it). Consider a trust "for" the surviving spouse in which the descendants are beneficiaries. A trusted child or other person could have a lifetime special power of appointment in favor of anyone; that power would be exercised every month, quarter, or year in favor of the spouse until that was inappropriate. The spouse would say accurately that no trusts were for his or her benefit. For Medicaid purposes, trusts under Will are favored over trust agreements.

5. In evaluating the income tax savings of portability planning, planners will want to consider that even for very large estates, the surviving spouse has the option of using the DSUE Amount by making a taxable gift to a grantor trust. The DSUE Amount is applied against a surviving spouse's taxable gift first before reducing the surviving spouse's Applicable Exclusion Amount (referred to as the basic exclusion amount). The grantor trust would provide the same estate tax benefits as the by-pass trust, but the assets would be taxed to the surviving spouse as a grantor trust thus allowing the trust assets to appreciate out of the surviving spouse's estate without being burdened by income taxes. If the assets appreciate, then this essentially solves the problem of the DSUE Amount being frozen in value. Moreover, the grantor trust likely provides for a power to exchange assets of equivalent value with the surviving spouse who can exchange high basis assets for low basis assets of the grantor trust prior to death and essentially effectuate a "step-up" in basis for the assets in the grantor trust.

6. Although a "step-up" in basis is great in theory, no tax will be saved if there is a loss at the time of death resulting in a "step-down" in basis or the asset is income in respect of a decedent (IRD). Furthermore, even if the assets receive a "step-up" in basis, will anyone benefit? Many assets, like family-owned businesses, may never be sold or may be sold so far in the future that the benefit of a step-up is attenuated. On the other hand, if the asset that receives a "step-up" in basis is either depreciable or depletable under the Code, the deductions that arise do result in tax benefits to the owners of that asset. Similarly, an increase in the tax basis of an interest in a partnership or in S corporation shares may not provide immediate tax benefits, but they do allow additional capacity of the partner or shareholder to receive tax free distributions from the entity. These concepts and how certain assets benefit or don't benefit from the basis adjustment at death are discussed in more detail below.

7. Portability planning is slightly less appealing to couples in community property states because, as discussed below, all community property gets a "step-up" in basis on the first spouse's death. Thus, the need for additional transfer tax exclusion in order to benefit from a subsequent "step-up" in basis is less crucial. This is not true, however, for assets that are depreciable (commercial real property) or depletable (mineral interests). As discussed below, these types of assets will receive a "step-up" in basis but over time, the basis of the asset will be reduced by the ongoing depreciation deductions. As such, even in community property states, if there are significant depreciable or depletable assets, portability should be considered.

II. OBTAINING AND RETAINING BASIS

A. Generally

1. As discussed above, estate planning will increasingly focus on the income tax savings resulting from the "step-up" in basis. Estate planners will seek to maximizing the "step-up" up in basis by ensuring that the assets that are includible in the estate of a decedent are the type of assets that will:

a. Benefit from a "step-up" (avoiding the inclusion cash or property that has a basis greater than fair market value)

b. Benefit the most from the "step-up" (for example, very low basis assets, collectibles, and "negative basis" assets); and

c. Provide significant income tax benefits to the beneficiaries (assets are likely to be sold in a taxable transaction after "step-up" or depreciable/depletable assets giving rise to ongoing income tax deductions).

2. In addition to the foregoing, estate planners will increasingly seek to:

a. Maximize the value of certain assets because the step-up" in basis is based on fair market value (rather than trying to reduce the value for transfer tax purposes); and

b. Intentionally create estate tax inclusion, especially if the decedent lives in a state with no state death tax and if the decedent has significant unused Available Exclusion Amount above his or her assets.

B. Swapping Assets with Existing Grantor Trusts

1. Many individuals have made significant taxable gifts, using all or a significant portion of their Available Exclusion Amounts. Many of those gifts were made to grantor trusts.

2. A common power used to achieve grantor trust status for the grantor trust is one described under section 675(4)(C), namely giving the grantor, the power, in a non-fiduciary capacity, to reacquire the trust corpus by substituting other property of an equivalent value. For income tax purposes, transactions between the grantor and the grantor trust will be disregarded. As such, grantors may exercise the power to swap high basis assets for low basis assets without jeopardizing the estate tax includibility of the assets and without having a taxable transaction for income tax purposes.

3. To maximize the benefits of the swap power, it must be exercised as assets appreciate or are sold over time. When exercised properly, this can ensure that only those assets that benefit the most from the step-up will be subject to estate inclusion.

a. If grantor does not have sufficient other assets, repurchase will be difficult - although the donor could borrow cash from a third party. What are the results if cash is borrowed by the grantor, the grantor buys assets from the trust, the trust loans the cash back to the grantor, the grantor pays back the third party lender and, at death, the grantor's estate satisfies the note to the trust with assets having fair market value basis?

b. The income tax consequences if a note is used to repurchase property are uncertain because the trust's basis in note may equal grantor's original carryover basis in the asset given to the trust and now reacquired so paying off the note may generate gain). In other words, if grantor trust status terminates because the grantor dies, and the trust owns a note from the grantor – now the grantor's estate – the note likely does not receive a step-up in basis so when the estate pays it off the trust will have gain.

c. Because the sudden or unexpected death of the grantor may make a repurchase difficult or impossible, estate planners may want to consider drafting "standby" purchase instruments to facilitate fast implementation of repurchase.

C. <u>Should Valuation Discounts Be Undone?</u>

1. Where assets have been divided among generations to create discounts, consideration should be given to undoing those arrangements if the effect is to depress the value of an estate below the amount of Available Exemption Amount in order to increase the income tax basis of the assets.

2. Discount entities could be dissolved or restated to allow the parties to the entity to withdraw.

a. An option could be given to a parent allowing the sale of the parent's interest to a child or children for undiscounted fair market value at death. Giving such an option to a parent would be a gift unless accompanied by adequate and full consideration.

b. If undivided interests in property are owned, agreements could be entered into that require all generations to consent to the sale of the property as one tract if any one owner wanted to sell. Quite obviously such agreements may be contrary to other estate planning or ownership goals of the family.

c. The ability of the IRS to ignore provisions of an agreement that increase the value of assets in the hands of a parent, but not in the hands of a child, is uncertain. By its literal terms, section 2703 of the Code applies only to provisions that reduce value and to restrictions on the right to sell or use property. To illustrate, in <u>Estate of James A. Elkins, Jr., et al. v. Commissioner</u>, 140 T.C. No. 5 (2013), the Tax Court applied section 2703 to ignore a family co-tenancy agreement requiring all owners of fractional interests in art to agree before the art could be sold. The purpose of that agreement was to limit the marketability of a fractional interest.

But what might the effect on value be of an agreement which provided, instead, that <u>any</u> fractional owner could <u>compel the sale</u> of the entire asset? Similarly, a provision that allowed a shareholder in business to put stock to the business at death for fair market value would seem to be outside the scope of the section. In many instances, amending old agreements to include such provisions will be more likely to create gift from the younger owners to the older than would terminating an old agreement and creating a new one.

D. Powers of Appointment For Basis Purposes

1. Generally

a. A general power of appointment, as defined in sections 2041(b)(1) and 2514(c) of the Code, is a power exercisable in favor of: (i) the powerholder, (ii) his or her estate, (iii) his or her creditors, or (iv) creditors of his or her estate. From a transfer tax standpoint, the mere existence of an exercisable general power of appointment at the death (a testamentary general power) of the powerholder will cause assets subject to the power to be includible in the powerholder's estate. Moreover, the lack of knowledge of the existence of a general power of appointment will not exclude the property subject to the power from being included in the estate of the deceased powerholder, as determined in Freeman Estate v. Commissioner, 67 T.C. 202 (1976). This is not unfair; section 2207 apportions the Federal estate tax attributable to the property subject to the power to such property. Section 2041(b)(2) provides that there will be estate tax inclusion if a general power lapses, if the powerholder has other rights in the property that would cause estate tax inclusion (e.g. a right to income under section 2036). Such a lapsing power may be a safer choice for inclusion than a continuous power.

b. Whether or not the holder of the power exercises a testamentary general power, the property passing under the power is deemed to have passed from the deceased power holder without full and adequate consideration, and the property will get a "step-up" in basis under Treas. Reg. § 1.1014-2(a)(4). Treas. Reg. §1.1014-2(b)(2).

c. Given the potential income tax savings from the "step-up" in basis and growing Applicable Exclusion Amounts in the future, estate planners will need to consider how, under what circumstances and to what extent a testamentary general power of appointment should be granted to future trust beneficiaries, even if the assets have been transferred into a vehicle (like a dynasty trust) that is structured to avoid estate tax inclusion at every generation. So-called limited general powers may be helpful in this respect. For example, a power to appoint only to the creditors of the powerholder's estate may be less susceptible to undesirable appointment than a power to appoint more broadly (who are the "creditors of an estate?"). Further, the exercise of a power may be subject to the consent of another person so long as the person does not have a substantial interest adverse to the exercise of the power in favor of the decedent, her estate, her creditors, or the creditors of her estate. Treas. Reg. § 20.2041-3(c)(2).

d. Consideration should be given to using a "circumscribed general power" that has the following characteristics: (1) a testamentary power, (2) in favor of the creditor of the powerholder's estate, (3) with the consent of a non-adverse party, (4) only over assets with a fair market value in excess of basis, and (5) capped such that the amount subject to the power when added to the other assets of the powerholder produces a total that is $1,000 less than the powerholder's Basic Exclusion Amount.

e. The rights of creditors to property over which a powerholder has a testamentary general power is worth considering. The majority view at common law is that the powerholder of a power, conferred on the powerholder by another, is treated as the beneficial owner of the appointive property for purposes of creditors' rights only if (1) the power is general *and* (2) the powerholder exercises the power. No distinction is made between a testamentary and a presently exercisable power. Creditors of a powerholder of a *non*general power, on the other hand, cannot reach the appointive assets even if the power was effectively exercised. The theory is that the donor who creates a nongeneral power did not intend to benefit the powerholder.

Explaining the distinction between the exercise and non-exercise of a general power for purposes of creditor access, Univ. Nat'l Bank v. Rhoadarmer, 827 P.2d 561 (Colo. App. 1991) noted:

> When a donor gives to another the power of appointment over property, the [powerholder]... does not thereby become the owner of the property. Rather, the appointee of the power [meaning, the powerholder], in its exercise, acts as a "mere conduit or agent for the donor." The [powerholder], having received from the owner of the property instructions as to how the power may be utilized, possesses nothing but the authority to do an act which the owner might lawfully perform.

When the powerholder of a general power exercises the power by will, the view that the appointed property is treated as if it were owned by the powerholder means that the creditors of the powerholder's estate can reach the appointed property for the payment of their claims. See, e.g., Clapp v. Ingraham, 126 Mass. 200 (1879). The rule prevails even if this is contrary to the expressed wishes of the donor of the power. See, e.g., State Street Trust Co. v. Kissel, 19 N.E.2d 25 (Mass. 1939).

The exercise of the power by will does not confer actual beneficial ownership of the appointive assets on the powerholder for all purposes. The assets do not ordinarily become part of the powerholder's probate estate. Thus, in terms of priority, the powerholder's own estate assets are ordinarily used first to pay estate debts, so that the appointive assets are used only to the extent the powerholder's probate estate is insufficient.

Under the majority view at common law, the powerholder's creditors can reach the appointive assets only to the extent the powerholder's exercise was an *effective* exercise. A few states, however, follow the view that even an ineffective exercise entitles the powerholder's creditors to reach the appointive assets. See, e.g., Estate of Breault, 211 N.E.2d 424 (Ill. App. Ct. 1965). Moreover, even in states adhering to the majority view, an ineffective exercise can sometimes "capture" the appointive assets for the powerholder's estate, in which case the appointive assets become part of the powerholder's probate estate for all purposes, including creditors' rights.

When the powerholder of a general power makes an inter vivos appointment, treating the appointed assets as if they were owned by the powerholder does not automatically mean that the powerholder's creditors can subject the appointed assets to the payment of their claims. If the appointment is in favor of a *creditor*, the powerholder's other, unsatisfied creditors can reach the appointed assets only by having the appointment avoided as a "preference" in bankruptcy proceedings. Apart from bankruptcy, the powerholder can choose to pay one creditor rather than another with his or her owned assets, and the same is true with respect to appointive assets. If the appointment is in favor of a *volunteer* (i.e., the appointment is gratuitous), the powerholder's creditors can reach the appointed assets only if the transfer is the equivalent of a fraudulent transfer under applicable state law.

In a minority of jurisdictions, the powerholder of a general power, conferred on him or her by another, is *not* treated as the owner of the appointive property even if the power is exercised. See, e.g., St. Matthews Bank v. DeCharette, 83 S.W.2d 471 (Ky. 1935). Of course, if the powerholder exercises the power in favor of himself or herself or his or her estate, the appointed property becomes owned in the technical sense, and creditors even in states adhering to the minority view would be able to subject the assets to the payment of their claims to the same extent as other property owned beneficially by the powerholder. A few states have enacted legislation that affect the rights of the powerholder's creditors. The legislation is not uniform. Some of the legislation expands the rights of the powerholder's creditors and some contracts them.

The Uniform Powers of Appointment Act takes the following position. If the power is conferred by another, the rights of the powerholder's creditors depend on whether the power is general or nongeneral. If the power is general, the appointive property is subject to a claim of (1) a creditor of the powerholder, to the extent the powerholder's property is insufficient, if the power is presently exercisable (whether or not actually exercised), and (2) a creditor of the powerholder's estate, to the extent the estate is insufficient, subject to the right of a decedent to direct the source from which liabilities are paid. See Uniform Act §502. If the power is nongeneral, the general rule is that creditors have no rights in the appointive property. See Uniform Act §504(a). Some states (including Kentucky) have reversed this rule when adopting the act.

2. Power of Appointment Not Subject to Fiduciary Standard. In In re Estate of Zucker, 2015 WL 5254061 (Pa. Superior Ct. 2015), decedent's wife, Syma, exercised a power of appointment in favor of two of three children. The third, Wendy, objected claiming:

> Wendy alleged that Syma's appointment was not a proper exercise of the power as it was done "in bad faith, based on hate and malice toward Wendy, contrary to [the Decedent's] intent to benefit his issue equally (absent a good faith reason to the contrary) and the duty imposed on Syma to act in good faith when exercising a testamentary power imposed by Pennsylvania law."

The court disagreed, declining even to impose a good faith standard. The opinion states:

> We have reviewed the language contained in Decedent's will and in the codicil to Syma's will in which she directed that the principal contained in the marital trust be divided into two trusts for the benefit of Scott and Karyn and their issue. We have also reviewed the case law provided by the parties and the orphans' court. We conclude that none of the cases, in which challenges to the exercise of the power of appointment were raised, direct that the appointments must be made in good faith. Rather, we state again that a donee's duty is to the donor and the donee must exercise that power within the donor's established conditions. Moreover, the donee has the right to select some of the potential appointees to the exclusion of others. See Estate of Kohler, 344 A.2d at 472. No duty of good faith has been

> established. Therefore, we conclude that the orphans' court's grant of Scott and Karyn's motion for judgment on the pleadings was proper. The orphans' court did not commit an error of law.

The court notes that Syma was not the trustee. Does that matter? Suppose she had been; her exercise of a testamentary power of appointment would seem to occur after service as trustee ended. May a trustee exercise an inter vivos power without following a fiduciary standard?

The California Court of Appeals held in Tubbs v. Berkowitz, 47 Cal.App.5th 548 (Cal.App. 2020), that where a surviving spouse is named both as trustee of a marital trust and is given a lifetime general power of appointment over the marital trust assets, the surviving spouse could exercise the nonfiduciary power of appointment even while serving as trustee. The opinion states:

> A trustee "has a duty to administer the trust according to the trust instrument ...." (§ 16000.) A trustee also only has the powers conferred by the trust instrument and the powers conferred by statute, unless limited by the trust instrument. (§ 16200.) Here, the very language of the Marital Trust allowed Berkowitz to act in his capacity as the surviving spouse (not the trustee) and designate himself as the recipient of the Trust assets. The Marital Trust then required the trustee to distribute the assets to any person designated by the surviving spouse, including the surviving spouse himself. Thus, under the plain terms of the Marital Trust, Berkowitz (acting as the trustee) was required to transfer the assets once he exercised the power of appointment in his favor. He could not possibly have breached any fiduciary duties by doing something that was expressly authorized and required under the terms of the Marital Trust. (*Hearst v. Ganzi* (2006) 145 Cal.App.4th 1195, 1207-1208, 52 Cal.Rptr.3d 473 [trustees did not breach their fiduciary duties where their actions were explicitly authorized by the trust].)
>
> Finally, we note that Berkowitz's exercise of his power of appointment would have been unobjectionable if he had resigned as trustee before exercising the power. In that scenario, the successor trustee (Tubbs) would have been required to transfer the assets to Berkowitz once he exercised the power of appointment in his favor. Tubbs claims "those are not the facts before this Court," but we see no reason why the result should be different where Berkowitz was both the donee and the trustee who had no discretion but to follow the terms of the power of appointment.

No authority is cited on the point (either way).

To the contrary is Peterson v. Peterson, 835 S.E.2d 651 (Ga. App. 2019), a much litigated matter whose facts were described as follows:

> Charles Hugh Peterson died testate in 1994 and was survived by his wife, Mary, and their three sons Alex, David, and Calhoun. Mr. Peterson's will, which was probated in 1995, created two testamentary trusts: a marital trust for the primary benefit of Mary, and a residual "by-pass" trust for the benefit of Mary and the couple's three sons. Mary and her three sons were each designated a co-executor of the will and a co-trustee of both the marital and by-pass trusts. Item 5 of Mr. Peterson's will created a marital trust for Mary, while Item 6 created a by-pass trust for Mary and their three sons. The relevant portion of the will creating the terms of the by-pass trust reads as follows:

> Trustees shall hold and manage the property in this trust and ... may encroach on such part of the principal thereof as the Trustees may deem necessary to provide for the support in reasonable comfort of my wife and to provide for the proper support and education of my descendants[.] To the extent practicable, however, I request the Trustees in making encroachment for the benefit of my wife to encroach first on any trust created for my wife ... before encroaching on this trust for my wife[.]
>
> My primary desire is that my wife be supported in reasonable comfort during her lifetime and that my children be supported in reasonable comfort during their lives; my secondary desire is that the principal of this trust be preserved as well as possible consonant with the consummation of my primary objective[.]
>
> [My wife] shall have no power to appoint [trust] property to herself, to her estate, to her creditors, or to the creditors of her estate.
>
> * * *
>
> Sometime after the will was probated, a dispute arose between the co-executors and co-trustees over the administration of the estate and the by-pass trust, pitting Mary and Calhoun against Alex and David. Alex and David filed petitions for accounting and damages for breach of duties as executors and trustees against Mary and Calhoun, and sought the removal of Mary and Calhoun as executors and trustees in probate court. Mary and Calhoun each moved for summary judgment on all claims, and the superior court granted their motions. Alex and David appealed those rulings.
>
> In the first appearance of this case before this Court, we reversed the trial court's grant of summary judgment to Calhoun in an unpublished opinion. See *Peterson I*. One month later, the Supreme Court of Georgia in *Peterson II* reversed the trial court's grant of summary judgment to Mary for similar reasons. Both cases held that material issues of fact remained with respect to Appellees' failure to fully fund the trusts at issue in the case and whether Appellees wasted assets. See *Peterson I*, slip op. at pp. 7-8, 10; *Peterson II*, 303 Ga. at 215-217 (3), 811 S.E.2d 309.

The trial court had held that Mary did not owe the other beneficiaries a fiduciary duty when exercising the power of appointment. Mary cited a Connecticut case, <u>Connecticut Bank & Trust Co. v. Lyman</u>, 170 A.2d 130 (Conn. 1961) but the Georgia court noted in <u>Lyman</u> the powerholder was not a trustee. The Georgia Court of Appeals went the other way, deciding Mary <u>did</u> have a fiduciary duty:

> In the present case, the potentiality of conflicts of interests with respect to Mary's requests for conveyance of all property in the by-pass trust to Calhoun is well documented in the litany of litigation that has transcended decades among the co-trustees and co-beneficiaries. As we find no law which could excuse Mary from her fiduciary duty under the trust, even if acting solely as a beneficiary under the trust, we find that the trial court erred in concluding that Mary could act exclusively in her capacity as a beneficiary of both trusts in exercising her appointment power to convey trust assets.

Having a power exercised when the powerholder is a trustee (or perhaps an advisor) is perilous.

Because the holder of a power of appointment is not a fiduciary, the holder of a lifetime power may have his or her actions attributed to a grantor or beneficiary. In the 1970s two cases dealing with the Goodwyn family established the principle that if a trust agreement prohibited the grantor from acting as de facto trustee the mere fact that the grantor did in fact act as de facto trustee would not established a retained interest under section 2036, Estate of Goodwyn, T. C. Memo. 1973-153, nor a power for the grantor trust provisions of sections 671ff, Estate of Goodwyn v. Commissioner, T.C. Memo. 1976-238.

> Under the terms of the deeds creating these trusts, the trustees were granted broad discretionary powers with respect to both the distribution of income to the beneficiaries and the investment and management of the corpus of the trusts. Notwithstanding the designation of Richards and Russell as trustees, it further appears that at all times from the establishment of the trusts until his last illness, the decedent exercised complete control with respect to the purchase and sale of trust assets, investment of any proceeds, and the determination of the amounts, if any, to be distributed to the respective beneficiaries.
>
> The assets of the various trusts, together with other trusts, as well as property owned by the decedent, were accounted for by a single set of records maintained in the offices of the decedent. Except for the Federal income tax returns prepared and filed by the decedent on behalf of the various trusts, no separate records were maintained showing the assets and income of any of these trusts.
>
> The respondent argues that the decedent should be treated as trustee, in fact, possessing such rights and powers as to cause the inclusion of the assets thereof in his gross estate, relying on sections 2033, 2036 (a)(2), and 2038. Section 2033 requires a finding that the decedent had an interest in the assets of the trusts at the time of his death. There is no basis for such a finding. Section 2038(a)(1) relates to "a power" exercisable by the decedent "to alter, amend, revoke, or terminate," the trusts. No such power was reserved by the decedent. Accordingly, in the final analysis the respondent's position is predicated on the determination that by reason of the de facto control exercised by the decedent the trusts are includable in his estate pursuant to section 2036(a)(2).[5] It is clear that the powers granted to the trustees would, if reserved by the decedent, be such as to require the inclusion of the assets of the trusts in the estate of the decedent. *United States v. O'Malley* [66-1 USTC ¶ 12,388], 383 U.S. 627 (1966). Does the fact that the decedent was able to exercise such powers through the cooperation of unrelated trustees require a different result? The question thus presented for decision is whether the value of such trusts is includable in the estate of the decedent by reason of the de facto control over the trusts exercised by the decedent, notwithstanding that no power to exercise such control was reserved to or by the decedent once he resigned his duties as trustee of certain of these trusts.

[footnotes omitted]

The Goodwyn rationales appear to be based on a trustee having authority; if an advisor who is not a fiduciary can direct a trustee, and the trustee must follow the direction, then will Goodwyn protect the grantor whose advisor follows the grantor's advice regularly. Similarly, where a grantor gives an inter vivos power of appointment to someone during the grantor's lifetime the Goodwyn rationale is inapplicable.

3. Power to Grant or Modify a Power. Give someone - - trustee, advisory committee, or trust protector - - the discretion to grant a general power of appointment or to expand a special power of appointment so that it becomes general. The power could be granted shortly before death if the step up in basis is desirable given the tax rates in effect at that time (considering, of course, that when a potential power holder is "shortly before" death may not always be easy to determine). Should the person with the power to grant or expand the power be a fiduciary? Should protection be given for a decision to grant or not to grant the power of appointment? Should the general power be able to be rescinded or modified by the person granting the power?

Where the circumstances are clearly defined, a formula grant of a general power may be easier, and more successful, that a broadly applicable formula. Again, the general power may lapse and still cause inclusion depending on the trust terms and whether the powerholder is a beneficiary.

Some commentators have asked whether someone having the ability to give a person a general power actually creates a general power in the person. The "alone or with anyone else" language of section 2041 could be read as being the person who can be given the power along with the person who can give the power. This issue was first discussed after the 1986 GST enactment. There is no authority on the issue. Many trusts since 1986 have contained provisions that authorize the grant of a general power.

4. Tax consequences of estate tax inclusion

a. Value of property at death is includible in gross estate.

b. Section 2001(b) of the Code provides that adjusted taxable gifts do not include gifts that are includible in the gross estate. Thus, there is a distinction between including assets in the estate of a beneficiary and including gifted assets in the estate of the donor.

c. There is no reduction available for gifts treated as having been made by spouse because of a split gift election, so estate tax inclusion generally should not be used for property for which a split gift election was made.

d. Question of how much is excluded from adjusted taxable gifts where less than all of the gifted property is includible in the estate (e.g. because of distributions of income or distributions of appreciation)? The issue does not seem to be addressed sections 2001, 2701 and 2702 of the Code and the Treasury Regulations. Ought the Code distinguish between the following two situations.

Donor makes a completed gift of $11 million of stock with a zero basis to a trust for donor's children. During donor's lifetime any income and appreciation in excess of $11 million is distributed to donor's children, free from transfer tax. At donor's death, the remaining $11 million of stock is not includible in donor's gross estate and is included in donor's adjusted taxable gifts. The basis in the stock will not be stepped up to the value on the date of death.

Same as the previous example except that donor retains the right to receive trust income during donor's lifetime. The donor's income interest does not reduce the value of the gift because it does not meet the requirements of section 2702. All appreciation is distributed to donor's children during donor's lifetime. On donor's death, the value of the trust assets are included in donor's estate - - $11,000,000 - - and receive a basis step-up. Are donor's adjusted taxable gifts reduced by donor's $11,000,000 gift, or only by the value of donor's income interest (which was what donor retained), and if the latter, at a zero value or some other value? The correct result would seem to be a zero reduction.

5. <u>Upstream Sale to a Power of Appointment Trust (UPSPAT)</u>. Suppose a child creates a grantor trust, sells assets to the trust for a note, gives the child's parent a testamentary general power of appointment over the trust assets so that the assets will be included in the parent's estate at the parent's death and receive new basis, and then the trust (which remains a grantor trust with respect to the child ever after the parent's death) uses the assets to pay off the note. The net effect is that the parent's net estate is increased by zero or a small amount yet the child receives new basis.

Because the contemplated transaction is not designed to remove assets from the child's estate for estate tax purposes, the section 2036 issues that require that the grantor trust be seeded would not apply. However, a sale to an unseeded trust could result in a note having a value less than its stated face value, thus causing child to make a gift. Parent's guarantee of the note could reduce that risk if the parent's assets are commensurate with the amount of the note.

Does the existence of the parent's general power cause the assets to be stepped up to full fair market value, or will the value of the note reduce the amount of the step-up? Section 2053(a)(4) provides that the value of the taxable estate will be reduced by indebtedness in respect of property included in a decedent's estate. Treas. Reg. § 20.2053-7 provides in relevant part:

> 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. If the decedent's estate is liable for the amount of the mortgage or indebtedness, the full value of the property subject to the mortgage or indebtedness must be included as part of the value of the gross estate; the amount of the mortgage or indebtedness being in such case allowed as a deduction. But if the decedent's estate is not so liable, only the value of the equity of redemption (or the value of the property, less the mortgage or indebtedness) need be retuned as part of the value of the gross estate. In no case may the deduction on account of the mortgage or indebtedness exceed the liability therefor contracted bona fide and for an adequate and full consideration in money or money's worth.

Thus the net increase to parent's estate would seem to be zero. If parent guaranteed the obligation then this concern would be reduced. Arguably such a step is unnecessary because the regulations may be read as discretionary or optional. Further, outside the trust context, Crane v. CIR, 331 US 1 (1947) suggests that the basis increase is based on the fair market value of the property regardless of the associated debt.

In thinking about this issue consider a QTIP or general power of appointment marital trust with $3,000,000 is non-divided paying Berkshire-Hathaway stock as assets. Suppose the trust borrows $100,000 and distributes the cash to spouse because spouse is not receiving any dividends. This might be an alternative to selling $100,000 worth of stock and incurring gain. At spouse's death the trust is worth $2,900,000 -- $3,000,000 less the $100,000 loan. Spouse is not personally liable for the $100,000 loan. Does the Berkshire-Hathaway stock receive a basis, in total, of $3,000,000 or $2,900,000? On the other hand, consider the child's grantor trust. Suppose parent actually appointed the assets to the parent's estate. Now the parent's estate has the trust assets, and the trust continues to owe the debt. If the debt is severable from the assets, has child made a child when the general power springs into existence? Again, the parent's guarantee is helpful.

If the amount over which parent has a testamentary general power of appointment is limited by formula to an amount that would not increase parent's taxable estate to more than the federal estate tax exclusion taking into consideration parent's other assets, then a basis adjustment can be obtained for that amount because there is no need for the debt to offset the assets included in parent's estate. The trust ought provide that it is for the benefit of the child's descendants, not the child, to avoid the one year prohibition of section 1014(e).

Might the IRS argue that payment on the note is an indirect return of assets to the child? To the extent the note is not for fair market value that would be a direct return of assets. Suppose the terms of the trust and the sale provided that no assets could be used to pay off the note beyond those required to satisfy the fair market value of the note as determined for federal gift tax purposes. The hoped for result would be that the amount of child's gift would be trapped in the trust and pass other than to a child.

Supposed child "sells" cash to the trust for a note. Section 1014(e) applied by its terms only to "appreciated property" acquired by the decedent by gift within one year prior to the decedent's death. If the cash in the grantor trust is later swapped for child's appreciated property that would not be appreciated property acquired by gift. The cash might have acquired in part by gift – if the note were not valued at par – but not the appreciated property. Is this extra step valuable in minimizing a challenge?

Does the death of parent terminate the grantor trust status of the trust? If yes, that would cause the sale to be recognized by child as of that moment, thus undoing the benefits of the transaction. (Unlike a sale to a grantor trust where grantor trust status terminates because the grantor dies; there the policy appears to be that death cannot, or ought not, trigger a taxable transaction.) Treas. Reg. §1.671-2(e)(1) provides that a grantor includes any person to the extent such person either creates a trust, or directly or indirectly makes a gratuitous transfer – defined as any transfer other than one for fair market value – of property to s trust. Section 678 by its terms confers grantor trust status (or status that is substantially similar to grantor trust status) only in situations involving inter vivos general powers. The IRS ruling position is that an inter vivos right to withdraw makes the powerholder a grantor under section 678 but not replacing the true grantor if one still exists. What is the effect of parent's testamentary general power of appointment? Treas. Reg. §1.671-2(e)(6) contains two examples that are close but not directly on point:

> Example 4. A creates and funds a trust, T. A does not retain any power or interest in T that would cause A to be treated as an owner of any portion of the trust under sections 671 through 677. B holds an unrestricted power, exercisable solely by B, to withdraw certain amounts contributed to the trust before the end of the calendar year and to vest those amounts in B. B is treated as an owner of the portion of T that is subject to the withdrawal power under section 678(a)(1). However, B is not a grantor of T under paragraph (e)(1) of this section because B neither created T nor made a gratuitous transfer to T.
>
> Example 8. G creates and funds a trust, T1, for the benefit of B. G retains a power to revest the assets of T1 in G within the meaning of section 676. Under the trust agreement, B is given a general power of appointment over the assets of T1. B exercises the general power of appointment with respect to one-half of the corpus of T1 in favor of a trust, T2, that is for the benefit of C, B's child. Under paragraph (e)(1) of this section, G is the grantor of T1, and under paragraphs (e)(1) and (5) of this section, B is the grantor of T2.

Note that this is the same issue which exists with respect to creating a lifetime QTIP trust that is a grantor trust with respect to the creating spouse. After the beneficiary spouse dies, the property may remain in trust for the benefit of the creating spouse and the couple's descendants becoming, essentially, a credit-shelter trust. However, if the creator spouse remains the grantor of the trust for income tax purposes that will produce a substantial additional transfer tax benefit.

6. <u>Income Tax Benefits</u>

a. Assets included in a parent's estate for estate tax purposes obtain a new income tax basis under section 1014(b)(9) but not if assets acquired by the parent from a child by gift within one year of the parent's death pass back to the child or the child's spouse (§1014(e)). Suppose that the assets pay into a trust for descendants only but a third party has a power of appointment to add beneficiaries to the trust?

Depreciable property has special issues. Section 1014(b)(9) limits the basis adjustment for depreciation taken by a taxpayer other than the decedent. Because the UPSTAT will remain a grantor trust as to the younger generation grantor who originally took the depreciation deduction, after the death of the older generation holder of the general power of appointment, then the amount of the basis adjustment might be reduced by the amount of the depreciation deductions allowed to the younger generation grantor prior to the older generation member's death. Treas. Reg. §1.1014-6 states:

> (a) In general.
>
> (1) The basis of property described in section 1014(b)(9) which is acquired from a decedent prior to his death shall be adjusted for depreciation, obsolescence, amortization, and depletion allowed the taxpayer on such property for the period prior to the decedent's death. Thus, in general, the adjusted basis of such property will be its fair market value at the decedent's death, or the applicable alternate

> valuation date, less the amount allowed (determined with regard to section 1016(a)(2)(B)) to the taxpayer as deductions for exhaustion, wear and tear, obsolescence, amortization, and depletion for the period held by the taxpayer prior to the decedent's death. The deduction allowed for a taxable year in which the decedent dies shall be an amount properly allocable to that part of the year prior to his death. For a discussion of the basis adjustment required by section 1014(b)(9) where property is held in trust, see paragraph (c) of this section. [dealing with uniform basis]

The Senate Finance Committee explained its purpose in 1954 as follows:

> Your committee added a specific rule for determining the basis of property transferred before the death of the decedent. So that the donee will not receive a double deduction it is provided that his new basis will be the value of the property at the date of the decedent's death . . . less the total of his deductions for depreciation, depletion, and amortization of property he received by gift. This rule will not involve the recomputation of the deductions already taken for the period prior to the decedent's death.

The situation the provision was designed for was where grantor gave property to X but retained an interest. X took deductions, then received a step-up, because of the string provisions, and took the deductions a second time. Arguably this is different from the UPSTAT because the decedent received nothing "by gift" but rather by purchase. Even though the purchaser was the grantor's grantor trust, the decedent guaranteed the debt.

PART 4 – FEDERAL RULINGS, CASES AND OTHER DEVELOPMENTS

A. INCOME TAX MATTERS

1. Consistent Basis Reporting. [WE AWAIT FINAL REGULATIONS] The IRS has issued Proposed Regulations under new sections 1014(F) and 6035. REG-127923-15. Treasury did not identify these Proposed Regulations as ones which impose an undue financial burden on taxpayers, add undue complexity to the Federal tax laws, or exceed the statutory authority of the IRS Notice 2017-38. The second quarter update to 2017-2018 Priority Guidance Plan puts regulations under section 1014(f) and 6045 in the "Near-Term Burden Reduction" category.

Prop. Reg. § 1.1014-10 deals with basis consistency. The summary to the Proposed Regulations states in part:

> A. Section 1014(f)
>
> Section 1014(f) imposes an obligation of consistency between the basis of certain inherited property and the value of that property for Federal estate tax purposes.
>
> Section 1014(f)(1) provides that the basis of property acquired from a decedent cannot exceed that property's final value for purposes of the Federal estate tax imposed on the estate of the decedent, or, if the final value has not been determined, the value reported on a statement required by section 6035(a).
>
> Section 1014(f)(2) provides that section 1014(f)(1) only applies to property the inclusion of which in the decedent's gross estate increased the estate's liability for the Federal estate tax (reduced by credits allowable against the tax).
>
> Section 1014(f)(3) provides that, for purposes of section 1014(f)(1), the basis of property has been determined for Federal estate tax purposes if (A) the value of the property is shown on a return under section 6018 and that value is not contested by the Secretary before the expiration of the time for assessing the estate tax; (B) in a case not described in (A), the value is specified by the Secretary and that value is not timely contested by the executor of the estate; or (C) the value is determined by a court or pursuant to a settlement agreement with the Secretary.

With respect to § 1014(f)(2), and <u>property that is both subject to and excluded from the requirements</u>, Prop. Reg. §1.1014-10(b) states:

> (b) Property subject to consistency requirement—(1) In general. Property subject to the consistency requirement in paragraph (a)(1) of this section is any property that is includable in the decedent's gross estate under section 2031,any property subject to tax under section 2106, and any other property the basis of which is determined in whole or in part by reference to the basis of such property (for example as the result of a like-kind exchange or involuntary conversion) that generates a tax liability under chapter 11 of subtitle B of the Code (chapter 11) on the decedent's estate in excess of allowable credits, except the credit for prepayment of tax under chapter 11.
>
> (2) Exclusions. For purposes of paragraph (b)(1) of this section, property that qualifies for an estate tax charitable or marital deduction under section 2055, 2056, or 2056A, respectively, does not generate a tax liability under chapter 11 and therefore is excluded from the property subject to the consistency requirement in paragraph (a)(1) of this section. For purposes of paragraph (b)(1) of this section, tangible personal property for which an appraisal is not required under § 20.2031-6(b) is deemed not to generate a tax liability under chapter 11 and therefore also is excluded from the property subject to the consistency requirement in paragraph (a)(1) of this section.
>
> (3) Application. For purposes of paragraph (b)(1) of this section, if a liability under chapter 11 is payable after the application of all available credits (other than a credit for a prepayment of estate tax), the consistency requirement in paragraph (a)(1) of this section applies to the entire gross estate (other than property excluded under paragraph (b)(2) of this section) because all such property contributes to the liability under chapter 11 and therefore is treated as generating a tax liability under chapter 11. If, however, after the application of all such available credits, no tax under chapter 11 is payable, the entire gross estate is excluded from the application of the consistency requirement.

In other words, gross estates under the Applicable Exclusion Amount are outside the consistency requirement (but note that the reporting requirements are separate). Property for which a marital or charitable deduction is allowed is not subject to the consistency rules either, nor is tangible personal property worth $3,000 or less (no appraisal required per Treas. Reg. § 20.2031-6(b)). IRD and cash are likewise excluded but not if the value is as a numismatic.

A taxpayer's initial basis may not exceed the final value of the property which the summary explains this way:

> Proposed § 1.1014-10(a)(1) provides that a taxpayer's initial basis in certain property acquired from a decedent may not exceed the final value of the property as that term is defined in § 1.1014-10(c). This limitation applies to the property whenever the taxpayer reports to the IRS a taxable event with respect to the property (for example, depreciation or amortization) and continues to apply until the property is sold, exchanged, or otherwise disposed of in one or more transactions that result in the recognition of gain or loss for Federal income tax purposes. The property for this purpose includes any other property the basis of which is determined in whole or in part by reference to the basis of the property acquired from the estate or as a result of the death of the decedent (for example as the result of a like-kind exchange or involuntary conversion).
>
> ***
>
> Section 1014(f)(3) provides that, for purposes of section 1014(f)(1), the final value of property has been determined for Federal estate tax purposes if: (A) The value is reported on a Federal estate tax return filed with the IRS and is not contested by the IRS before the period of limitation on assessment expires; (B) the value is specified by the IRS and is not timely contested by the executor of the estate; or (C) the value is determined by a court or pursuant to a settlement agreement with the IRS.
>
> Proposed § 1.1014-10(c)(1) defines the final value of property that is reported on a Federal estate tax return filed with the IRS. That value is the value reported on the Federal estate tax return once the period of limitations on assessment for adjusting or contesting that value has expired. The IRS may specify a value for the property by determining a value in the course of carrying out its responsibilities under section 7803(a)(2). If the IRS determines a value different from the value reported, the final value is the value determined by the IRS once that value can no longer be contested by the estate. If the value determined or specified by the IRS is timely contested by the estate, the final value is the value determined in an agreement that is binding on all parties, or the value determined by a court once the court's determination is final.
>
> Proposed § 1.1014-10(c)(2) provides that the recipient of property to which the consistency requirement applies may not claim a basis in excess of the value reported on the statement required to be furnished under section 6035(a) (the value shown on the Federal estate tax return) if the taxpayer's basis in the property is relevant for any purpose under the Internal Revenue Code before the final value of that property has been determined under proposed § 1.1014-10(c)(1). However, under section 1014(f)(1), basis cannot exceed the property's final value. Therefore, proposed § 1.1014-10(c)(2) provides that, if the final value is determined before the period of limitation on assessment expires for any Federal income tax return of the recipient on which the taxpayer's basis is relevant and the

> final value differs from the initial basis claimed with respect to that return, a deficiency and an underpayment may result.

These requirements may create problems for personal representatives who "horse trade" with the IRS during estate tax audits. Not only does the amount of estate tax matter, but the valuation of specific assets does as well.

Suppose a beneficiary disagrees with a personal representative. That is a state law actionable item except that a beneficiary who wins may have no federal recourse. Suggestions that a beneficiary should be able to file a protective claim have been made.

What if property is omitted from the Form 706 or discovered later after the Form 706 has been filed? Prop. Reg. §1.1014-10(c)(3) provides:

> (3) After-discovered or omitted property—(i) Return under section 6018 filed. In the event property described in paragraph (b)(1) of this section is discovered after the estate tax return under section 6018 has been filed or otherwise is omitted from that return (after-discovered or omitted property), the final value of that property is determined under section (c)(3)(i)(A) or (B) of this section.
>
> (A) Reporting prior to expiration of period of limitation on assessment. The final value of the after-discovered or omitted property is determined in accordance with paragraph (c)(1) or (2) of this section if the executor, prior to the expiration of the period of limitation on assessment of the tax imposed on the estate by chapter 11, files with the IRS an initial or supplemental estate tax return under section 6018 reporting the property.
>
> (B) No reporting prior to expiration of period of limitation on assessment. If the executor does not report the after-discovered or omitted property on an initial or supplemental Federal estate tax return filed prior to the expiration of the period of limitation on assessment of the tax imposed on the estate by chapter 11, the final value of that unreported property is zero. See Example 3 of paragraph (e) of this section.
>
> (ii) No return under section 6018 filed. If no return described in section 6018 has been filed, and if the inclusion in the decedent's gross estate of the after-discovered or omitted property would have generated or increased the estate's tax liability under chapter 11, the final value, for purposes of section 1014(f), of all property described in paragraph (b) of this section is zero until the final value is determined under paragraph (c)(1) or (2) of this section. Specifically, if the executor files a return pursuant to section 6018(a) or (b) that includes this property or the IRS determines a value for the property, the final value of all property described in paragraph (b) of this section includible in the gross estate then is determined under paragraph (c)(1) or (2) of this section.

Section 6035 creates <u>separate</u> notification requirements. Those requirements are burdensome. The basic requirements are described by the summary as follows:

> 7. Requirement To Provide Information Return and Statement(s) Under Section 6035

The proposed regulations define the term Information Return as the Form 8971, Information Regarding Beneficiaries Acquiring Property from a Decedent, which includes a copy of a Schedule A (Statement) for each person who has received or will receive property from the estate or by reason of the decedent's death.

Proposed § 1.6035-1(a)(1) provides that an executor who is required to file a Federal estate tax return also is required to file an Information Return with the IRS to report the final value of certain property, the recipient of that property, and other information prescribed by the Information Return and the related instructions. The executor also is required to furnish a Statement to each beneficiary who has acquired (or will acquire) property from the decedent or by reason of the death of the decedent to report the property the beneficiary has acquired (or will acquire) and the final value of that property.

8. Circumstances Under Which No Information Return or Statement(s) Is Required Under Section 6035

Commenters expressed concern that the section 6035 filing requirements might extend to a return filed by an estate solely to make the portability election under section 2010(c)(5), or a generation-skipping transfer tax election or exemption allocation. The proposed regulations provide that the filing requirements of section 6035 do not apply to such returns because these returns are not required by section 6018.

9. Property To Be Reported on an Information Return and Statement(s)

Commenters requested that the regulations clarify the types of property to be reported on the Information Return and one or more Statements. In response, proposed § 1.6035-1(b) defines the property to be reported on an Information Return and Statement(s) as all property included in the gross estate for Federal estate tax purposes with four exceptions: Cash (other than coins or paper bills with numismatic value); income in respect of a decedent; those items of tangible personal property for which an appraisal is not required under § 20.2031-6(b); and property that is sold or otherwise disposed of by the estate (and therefore not distributed to a beneficiary) in a transaction in which capital gain or loss is recognized.

10. Beneficiaries

Proposed § 1.6035-1(c)(1) provides that each beneficiary (including a beneficiary who is also the executor of the estate) who receives property to be reported on the estate's Information Return must receive a copy of the Statement reporting the property distributable to that beneficiary. Proposed § 1.6035-1(c)(2) provides that, if the beneficiary is a trust, estate, or business entity instead of an individual, the executor is to furnish the entity's Statement to the trustee, executor, or to the business entity itself, and not to the beneficiaries of the trust or estate or to the owners of the business entity.

***

Proposed § 1.6035-1(c)(4) provides that, if the executor is unable to locate a beneficiary by the due date of the Information Return, the executor is required to report that on that Information Return and explain the efforts taken to locate the beneficiary. If the executor subsequently locates the beneficiary, the executor is required to furnish the beneficiary with a Statement and file a supplemental

> Information Return with the IRS within 30 days of locating the beneficiary. If the executor is unable to locate a beneficiary and distributes the property to a different beneficiary who was not identified in the Information Return as the recipient of that property, the executor is required to file a supplemental Information Return with the IRS and furnish the successor beneficiary with a Statement within 30 days after distributing the property.

In most estates, assets may be divided among multiple beneficiaries. Every beneficiary must receive a report of every asset the beneficiary could receive. Estates that pour into a trust will be simpler to deal with, however, the executor must report regarding the trust assets too.

Controversially, the IRS expanded reporting to subsequent transfers. The summary states:

> As discussed earlier in this preamble, section 6035(a)(2) imposes a reporting requirement on the executor of the decedent's estate and on any other person required to file a return under section 6018. The purpose of this reporting is to enable the IRS to monitor whether the basis claimed by an owner of the property is properly based on the final value of that property for estate tax purposes. The Treasury Department and the IRS are concerned, however, that opportunities may exist in some circumstances for the recipient of such reporting to circumvent the purpose of the statute (for example, by making a gift of the property to a complex trust for the benefit of the transferor's family).
>
> Accordingly, pursuant to the regulatory authority granted in section 6035(b)(2), the proposed regulations require additional information reporting by certain subsequent transferors in limited circumstances. Specifically, proposed § 1.6035-1(f) provides that, with regard to property that previously was reported or is required to be reported on a Statement furnished to a recipient, when the recipient distributes or transfers (by gift or otherwise) all or any portion of that property to a related transferee, whether directly or indirectly, in a transaction in which the transferee's basis for Federal income tax purposes is determined in whole or in part with reference to the transferor's basis, the transferor is required to file and furnish with the IRS and the transferee, respectively, a supplemental Statement documenting the new ownership of this property. This proposed reporting requirement is imposed on each such recipient of the property. For purposes of this provision, a related transferee means any member of the transferor's family as defined in section 2704(c)(2), any controlled entity (a corporation or any other entity in which the transferor and members of the transferor's family, whether directly or indirectly, have control within the meaning of section 2701(b)(2)(A) or (B)), and any trust of which the transferor is a deemed owner for income tax purposes.
>
> In the event such transfer occurs before a final value is determined within the meaning of proposed § 1.1014-10(c), the transferor must provide the executor with a copy of the supplemental Statement filed with the IRS and furnished to the transferee reporting the new ownership of the property. When a final value is determined, the executor will then provide a supplemental Statement to the new transferee instead of to the transferor. The supplemental Statements are due no later than 30 days after the transferor distributes or transfers all or a portion of the property to the transferee.

The effective date is when Final Regulations are published. Reporting has been extended until June 30, 2016 for estates of decedents dying after July 31, 2015.

Treasury personnel believe they have clear regulatory authority to impose subsequent reporting. Reporting requirements terminate upon the determination of basis by a sale. Suppose immediately after death an estate sold property to the decedent's revocable trust which is the recipient of the property. The sale would be for fair market value plus a nominal amount such as $3,000 and would be for a note. The estate would recognize gain on $1,000 and would thereafter be outside the system. The note would be distributed to the revocable trust.

After June 30, 2016 (Notice 2016-27), the due dates of the Form 8971 will be "(i) The date that is 30 days after the due date of the estate tax return required by section 6018 (including extensions, if any), or (ii) The date that is 30 days after the date on which that return is filed with the IRS." Under certain circumstances the information must be supplemented:

> (e) Duty to supplement.—(1) In general. In the event of any adjustment to the information required to be reported on the Information Return or any Statement as described in paragraph (e)(2) of this section, the executor must file a supplemental Information Return with the IRS including all supplemental Statements and furnish a corresponding supplemental Statement to each affected beneficiary by the due date described in paragraph (e)(4) of this section.
>
> (2) Adjustments requiring supplement. Except as provided in paragraph (e)(3) of this section, an adjustment to which the duty to supplement applies is any change to the information required to be reported on the Information Return or Statement that causes the information as reported to be incorrect or incomplete. Such changes include, for example, the discovery of property that should have been (but was not) reported on an estate tax return described in section 6018, a change in the value of property pursuant to an examination or litigation, or a change in the identity of the beneficiary to whom the property is to be distributed (pursuant to a death, disclaimer, bankruptcy, or otherwise). Such changes also include the executor's disposition of property acquired from the decedent or as a result of the death of the decedent in a transaction in which the basis of new property received by the estate is determined in whole or in part by reference to the property acquired from the decedent or as a result of the death of the decedent (for example as the result of a like-kind exchange or involuntary conversion). Changes requiring supplement pursuant to this paragraph (e)(2) are not inconsequential errors or omissions within the meaning of § 301.6722-1(b) of this chapter.
>
> (3) Adjustments not requiring supplement—(i) In general. A supplemental Information Return and Statement may but they are not required to be filed or furnished
>
> (A) To correct an inconsequential error or omission within the meaning of § 301.6722-1(b) of this chapter, or
>
> (B) To specify the actual distribution of property previously reported as being available to satisfy the interests of multiple beneficiaries in the situation described in paragraph (c)(3) of this section.

The timing requirements of supplemental reporting is strict:

> Due date of supplemental reporting—(i) In general. Except as provided in paragraph (e)(4)(ii) of this section, the supplemental Information Return must be

filed and each supplemental Statement must be furnished on or before 30 days after—

(A) The final value within the meaning of § 1.1014-10(c)(1) is determined;

(B) The executor discovers that the information reported on the Information Return or Statement is otherwise incorrect or incomplete, except to the extent described in paragraph (e)(3)(i) of this section; or

(C) A supplemental estate tax return under section 6018 is filed reporting property not reported on a previously filed estate tax return pursuant to § 1.1014-10(c)(3)(i). In this case, a copy of the supplemental Statement provided to each beneficiary of an interest in this property must be attached to the supplemental Information Return.

(ii) Probate property or property from decedent's revocable trust. With respect to property in the probate estate or held by a revocable trust at the decedent's death, if an event described in paragraph (e)(4)(i)(A), (B), or (C) of this section occurs after the decedent's date of death but before or on the date the property is distributed to the beneficiary, the due date for the supplemental Information Return and corresponding supplemental Statement is the date that is 30 days after the date the property is distributed to the beneficiary. If the executor chooses to furnish to the beneficiary on the Statement information regarding any changes to the basis of the reported property as described in § 1.1014-10(a)(2) that occurred after the date of death but before or on the date of distribution, that basis adjustment information (which is not part of the requirement under section 6035) must be shown separately from the final value required to be reported on that Statement.

(f) Subsequent transfers. If all or any portion of property that previously was reported or is required to be reported on an Information Return (and thus on the recipient's Statement or supplemental Statement) is distributed or transferred (by gift or otherwise) by the recipient in a transaction in which a related transferee determines its basis, in whole or in part, by reference to the recipient/transferor's basis, the recipient/transferor must, no later than 30 days after the date of the distribution or other transfer, file with the IRS a supplemental Statement and furnish a copy of the same supplemental Statement to the transferee. The requirement to file a supplemental Statement and furnish a copy to the transferee similarly applies to the distribution or transfer of any other property the basis of which is determined in whole or in part by reference to that property (for example as the result of a like-kind exchange or involuntary conversion). In the case of a supplemental Statement filed by the recipient/transferor before the recipient/transferor's receipt of the Statement described in paragraph (a) of this section, the supplemental Statement will report the change in the ownership of the property and need not provide the value information that would otherwise be required on the supplemental Statement. In the event the transfer occurs before the final value is determined within the meaning of proposed § 1.1014-10(c), the transferor must provide the executor with a copy of the supplemental Statement filed with the IRS and furnished to the transferee in order to notify the executor of the change in ownership of the property. When the executor subsequently files any Return and issues any Statement required by paragraphs (a) or (e) of this section, the executor must provide the Statement (or supplemental Statement) to the new transferee instead of to the transferor. For purposes of this provision, a related transferee means any member of the transferor's family as defined in section 2704(c)(2), any controlled entity (a corporation or any other entity in which the transferor and members of the transferor's family (as defined in section

> 2704(c)(2)), whether directly or indirectly, have control within the meaning of section 2701(b)(2)(A) or (B)), and any trust of which the transferor is a deemed owner for income tax purposes. If the transferor chooses to include on the supplemental Statement provided to the transferee information regarding any changes to the basis of the reported property as described in § 1.1014-10(a)(2) that occurred during the transferor's ownership of the property, that basis adjustment information (which is not part of the requirement under section 6035) must be shown separately from the final value required to be reported on that Statement.

There are penalty provisions as well described by the summary:

> Section 2004(c) of the Act added a new accuracy-related penalty for underpayments attributable to an inconsistent estate basis. See section 6662(b)(8).
>
> Section 6662(k) provides that there is an inconsistent estate basis if the basis of property claimed on a return exceeds the basis as determined under section 1014(f).
>
> Section 2004(c) of the Act adds statements under section 6035 to the list of information returns and payee statements subject to the penalties under section 6721 and section 6722, respectively. Specifically, the Act adds new paragraph (D) to section 6724(d)(1) to provide that the term information return means any statement required to be filed with the Secretary under section 6035. The Act also adds new paragraph (II) to section 6724(d)(2) to provide that the term payee statement means any statement required to be furnished under section 6035 (other than a statement described in section 6724(d)(1)(D)).

2. Supreme Court Decides Kaestner But Teaches Little. (This appeared as an article by Turney P. Berry and Clary A. Redd in the August, 2019 issue of Trusts and Estates. Used with permission.) The Supreme Court, in a unanimous decision, has held in favor of the taxpayer in North Carolina Department of Revenue v. Kimberley Rice Kaestner 1992 Family Trust, 139 S. Ct. 915 (2019). The Court held that North Carolina can't tax trust income based solely on the presence of in-state beneficiaries when the beneficiaries had no right to demand the income and weren't certain to receive it. Although unanimous opinions are often referred to as sweeping, Kaestner was clearly designed to be a narrow and limited opinion, fully answering the question before the Court but going no further.

The trust involved was established in 1992 when the settlor and the initial trustee were each residents of New York and the trust instrument provided that New York law was to govern. The successor trustee of the 1992 trust, and initial trustee of three trusts resulting from a 2002 division of the 1992 trust, was a Connecticut resident. One of those 2002 trusts was for the benefit of Kaestner and her children (the "Kaestner Trust"), all of whom resided in North Carolina from 2005 to 2008, the tax years at issue. During that period, the assets of the Kaestner trust were held by a Boston custodian, but the tax returns and trust accountings were prepared in New York, which was also the location of the books and records for the trust.

All distributions from the Kaestner Trust were to be made, if at all, by the trustee in his discretion. Neither Kaestner nor her children received distributions from the Kaestner Trust between 2005 and 2008. Kaestner and the trustee twice met in New York in those years to discuss trust investments and whether Kaestner wished to receive distributions. In 2009, following a request from Kaestner, the trustee transferred the Kaestner Trust's assets to a new trust, the KER Family Trust.

North Carolina law provides that the state may tax the income of a trust that is for the benefit of a resident of North Carolina. Accordingly, each year, from 2005 to 2008, the Kaestner Trust paid North Carolina income tax. In 2009, the trustee filed a claim for a refund of the taxes paid, which the North Carolina Department of Revenue denied in 2011. The Kaestner Trust then sued the Department of Revenue alleging the North Carolina statute imposing income tax on a trust for the benefit of a North Carolina resident was unconstitutional under the Due Process and Commerce Clauses of the U.S. Constitution as well as Article I, Section 19 of the North Carolina Constitution. The Commerce Clause argument wasn't addressed by the Court of Appeals of North Carolina and therefore wasn't addressed in the Supreme Court of North Carolina decision.

The trustee won before the North Carolina Supreme Court, which quoted Quill Corp. v. North Dakota, 504 U.S. 298 (1992), and noted that the Due Process Clause requires "some definite link, some minimum connection, between a state and a person, property or transaction [the government] seeks to tax." In addition, the court observed that the income attributed to the State for tax purposes must be rationally related to values connected with the taxing State. The court therefore concluded that the beneficiaries' contact with North Carolina was insufficient to satisfy the requirements of due process and ruled that the statute at issue was unconstitutional as applied to the Kaestner Trust. The court acknowledged two cases in other jurisdictions cited by the Department of Revenue. In Chase Manhattan Bank v. Gavin, 249 Conn. 172, 733 A.2d 782 (Conn. 1999), cert. denied, 528 U.S. 965, the Supreme Court of Connecticut held that Connecticut's taxation of the income of an inter vivos trust didn't violate due process because the trust's beneficiary was a Connecticut domiciliary. The court pronounced *Gavin* unpersuasive and declined to follow it. In McCulloch v. Franchise Tax Board, 390 P.2d 412 (Cal. 1964), the Supreme Court of California ruled that California could tax the income of a trust in part because the beneficiary was a California resident. The court found McCulloch distinguishable from Kaestner because an important fact in McCullough, that the trustee was domiciled in California, wasn't present in Kaestner. *Gavin* followed District of Columbia v. Chase Manhattan Bank, 689 A.2d 539, 540 (D.C.App.1997) which concluded, after Quill, that the District of Columbia could tax the net income of a testamentary trust created by the will of an individual who died while domiciled in the District even when none of the trustee, trust assets, or trust beneficiaries were in the District. Some other states in recent years have reached the same conclusion on largely the same grounds. See, e.g, McNeil v. Commonwealth of Pennsylvania, 67 A. 3d 185 (Pa. Comwlth. 2013); Residuary Trust A V. Director, Div. of Taxation, 27 N. J. Tax 68 (January 3, 2013); Linn v. Department of Revenue, 2 N.E.3d 1203 (Ill. App. 2013).

The United States Supreme Court, also beginning with Quill, largely agreed, holding that due process requires a "minimum connection" between the state and the person, property or transaction it seeks to tax. The notion of minimum connection we remember from the Court's landmark decision in International Shoe Co. v. Washington, 326 U.S. 310 (1945), which the Court applied here stating: "[u]ltimately, only those who derive 'benefits and protection' from associating with a State should have obligations to the State in question." North Carolina had argued before the Court that in-state beneficiaries certainly derive benefits and protection from the state, and so one might infer that the Court was leaning in the State's direction.

Not so fast. The Court observed that no income was distributed to the beneficiaries and that they had no right to receive any income on demand. Because the beneficiaries didn't receive or have a right to income, the Court concluded there was no connection between the state and the thing being taxed, the income, as required by the Due Process Clause. The Court didn't believe it was generating new law, and the opinion notes earlier cases in which, in the context of beneficiary contacts, specifically, the Court focused on the extent of the in-state beneficiary's right to control, possess, enjoy or receive trust assets and stated:

> The Court's emphasis on these factors emerged in two early cases, Safe Deposit & Trust Co. of Baltimore v. Virginia, 280 U.S. 83 (1929), and Brooke v. Norfolk, 277 U.S. 27 (1928), both of which invalidated state taxes premised on the in-state residency of beneficiaries. In each case the challenged tax fell on the entirety of a trust's property, rather than on only the share of trust assets to which the beneficiaries were entitled.
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> ***
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> On the other hand, the same elements of possession, control, and enjoyment of trust property led the Court to uphold state taxes based on the in-state residency of beneficiaries who did have close ties to the taxed trust assets. The Court has decided that States may tax trust income that is actually distributed to an in-state beneficiary. In those circumstances, the beneficiary "own[s] and enjoy[s]" an interest in the trust property, and the State can exact a tax in exchange for offering the beneficiary protection. Maguire, 253 U.S., at 17; see also Guaranty Trust Co. v. Virginia, 305 U. S. 19, 21–23 (1938).

In Maguire v. Trefry, 40. S. Ct. 417 (1920), the Court confronted a testamentary trust created by a Pennsylvania testator, with a Philadelphia trustee but a Massachusetts beneficiary. The Court held that the beneficiary who had an income interest and received income from a trust could be taxed on that interest, that is, on the income. In so holding, the Court distinguished other kinds of interests, like tangible personal property in the form of railroad cars held outside of Kentucky by a Kentucky corporation which could not be taxed by Kentucky (Union Transit v. Kentucky, 199 U.S. 194 (1905)), versus intangible personal property that Kentucky could tax – bank deposits outside of Kentucky (Fidelity & Columbia Trust Co. v. Louisville, 245 U.S. 54 (1917)). The Kaestner Court's citation of Guaranty Trust is interesting because that case involved a testamentary trust set up in New York by the husband of Mary T. Ryan, a resident of Virginia. New York taxed all the income of the trust and Virginia taxed the income paid to Mrs. Ryan; the Court held that double taxation did not violate the Fourteenth Amendment, either the Equal Protection or Due Process Clauses, citing earlier cases that had held multiple states could in various circumstances tax the same income: "The mere fact that another state lawfully taxed funds from which the payments were made did not necessarily destroy Virginia's right to tax something done within her borders. After much discussion the applicable doctrine was expounded and applied in Lawrence v. State Tax Commission, 286 U.S. 276, 52 S.Ct. 556, 76 L.Ed. 1102, 87 A.L.R. 374, and New York ex rel. Cohn v. Graves, 300 U.S. 308, 57 S.Ct. 466, 81 L.Ed. 668. The attempt to draw a controlling distinction between them and the present cause, we think has not been successful." Guaranty Trust Co. of N.Y. v. Com. of Va., 59 S.Ct. 1 at 3 (1938).

States have many different strategies for taxing trust income that generally depend on the presence of one or more of the following factors:

- If the trust was established by will, whether the testator resided in the state at his death (the "testator residence test");
- If the trust was established by an *inter vivos* instrument, whether the settlor resided in the state at the time the trust was established (if the trust was irrevocable from the moment of establishment) or at the time the trust became irrevocable (if the trust, at the time of establishment, was revocable) (the "settlor residence test");
- The location of the trust property;
- Whether the trust is administered in the state (the "place of administration test");
- Where the trustee resides (the "trustee residence test");
- Where the beneficiaries reside (the "beneficiary residence test"); and
- Whether the trust instrument provides that the trust is to be governed by the law of the state.

There is a dizzying array of possible state income tax outcomes for nongrantor trusts depending on the subject trust's facts and circumstances. For example:

- If the trust was established by the will of a testator who resided in a state whose laws impose the testator residence test ("State A"), or if the trust, irrevocable from the moment of establishment, was established, by an inter vivos instrument, by a settlor who resided in a state whose laws impose the settlor residence test, the trust will be considered a resident of that state, and so will be subject to that state's income tax regime, indefinitely, regardless of the presence (or lack thereof) of any other factors. See, for example, Me. Rev. Stat. Ann. Tit. 36, §5102(4)(B),(C); Neb. Rev. Stat. §77-2714.01(6)(b),(c).
- If the trust is administered in a state whose laws impose the place of administration test ("State B"), the trust will be considered a resident of that state, and so will be subject to that state's income tax regime, for as long as the trust continues to be administered in that state, regardless of the presence (or lack thereof) of any other factors. See, for example, Colo. Rev. Stat. §39-22-103(10); S.C. Code Ann. §12-6-30(5).

- If the trust has one or more beneficiaries residing in a state whose laws impose the beneficiary residence test ("State C"), the trust will be considered a resident of that state, and so will be subject to that state's income tax regime, for as long as one or more beneficiaries continue to reside in that state, regardless of the presence (or lack thereof) of any other factors. See, for example, Tenn. Code Ann. §67-2-110(a).

- If the trust is considered a resident of a given state because of the testator residence test or the settlor residence test, but no trust beneficiaries reside in the state, the state's laws don't impose income tax on the undistributed income and realized capital gains of the trust. See, for example, Del. Code Ann. §1636; §143.331, RSMo.

- If the trust was established by a testator or settlor who resided in State A, is administered in State B and has one or more beneficiaries residing in State C, the trust will be subject to the income tax regimes of all three states! Depending on the identity of State A, State B and State C, there may or may not be credits under the laws of one or two of the states that would partially offset the income tax required to be paid to the other state or states.

- If the trust was established by a testator or settlor who resided in State B, the trust is administered in State A and no beneficiary of the trust resides in State C, the trust isn't subject to the income tax regime of any state, notwithstanding that each such state has a statutory scheme that imposes income tax on the undistributed income and realized capital gains of resident nongrantor trusts.

The Kaestner opinion doesn't answer what connections may pass muster if beneficiary residence alone is insufficient. Instead, the Court simply said that the test will be the same for any "position" within a trust. The Court states:

> In sum, when assessing a state tax premised on the in-state residency of a constituent of a trust—whether beneficiary, settlor, or trustee—the Due Process Clause demands attention to the particular relationship between the resident and the trust assets that the State seeks to tax. Because each individual fulfills different functions in the creation and continuation of the trust, the specific features of that relationship sufficient to sustain a tax may vary depending on whether the resident is a settlor, beneficiary, or trustee.

As if that were not sufficiently oblique, footnote 8 quite clearly reflects the Court's reluctance to tread one inch beyond the facts of the case before it: "[a]s explained below, we hold that the Kaestner Trust beneficiaries do not have the requisite relationship with the Trust property to justify the State's tax. We do not decide what degree of possession, control, or enjoyment would be sufficient to support taxation."

The Court might have provided additional guidance had it granted certiorari in the Fielding case, but it didn't. Bauerly v. Fielding, et al., cert. denied, 139 S. Ct. 2773 (June 28, 2019) (No. 18-664). In Fielding v. Comm'r of Revenue, 2018 WL 3447690 (Minn. July 18, 2018), aff'g, 2017 Minn. Tax LEXIS 28 (Minn.T.C. 2017), a settlor formed four trusts in 2009 while domiciled in Minnesota. The original trustee was a Californian. The successor trustee was a Texan. All but one of the beneficiaries were non-Minnesota residents and all trust administrative functions occurred outside Minnesota.

Initially, the trusts were grantor trusts for Minnesota income tax purposes, but in 2011 the settlor relinquished the power to substitute trust assets, and the trusts then ceased to "grantor type trusts" and became irrevocable within the meaning of Minnesota income tax law. Minnesota law defines a "resident trust," in part, as an irrevocable trust, the grantor of which was domiciled in this state at the time it became irrevocable. At the time the trusts became irrevocable, the settlor was domiciled in Minnesota.

In 2014, the trusts received income from investments as well as gains from the sale of stock. The Minnesota Commissioner of Revenue took the position that the trusts were "resident trusts" under Minnesota's statutory definition of "resident trust." The trustee's view was that Minnesota's statutory definition of "resident trust" violated the due process provisions of the Minnesota and U.S. Constitutions.

The Supreme Court of Minnesota began with "a minimum connection" analysis and held that Minnesota's "resident trust" definition failed the due process analysis for three reasons.

First, the court held that settlor's residence at the time the trusts became irrevocable was "not relevant to the relationship between the Trusts' income that Minnesota seeks to tax and the protection and benefits Minnesota provided to the Trusts' activities that generated that income. The relevant connections are Minnesota's connection to the trustee, not the connection to the grantor who established the trust years earlier." Thus, the court looked largely to the trusts' independence as a legal entity, separate from the settlor or beneficiary.

Second, the trusts owned no physical property in Minnesota that might serve as a basis of taxation. The trusts owned stock of a Minnesota company, intangible property, but that intangible property was held outside Minnesota.

Third, the court didn't find relevant any contacts with Minnesota by the settlor, the trusts or the beneficiaries that occurred prior to the tax year at issue. The court stated that the facts relevant to evaluating the sufficiency of a taxpayer's contacts are drawn from the tax year at issue.

A reasonable interpretation of the denial of certiorari is that the Court believed Kaestner would not have altered the Fielding result; otherwise, the Court could have suggested that Fielding be reconsidered in view of Kaestner. We reach that conclusion judiciously because to infer from a negative can be unreliable. In particular, note that the Fielding result is inconsistent with Gavin and District of Columbia v. Chase Manhattan Bank as discussed above. Of course, certiorari was also denied in Chase Manhattan Bank v. Gavin, 120 S. Ct. 401 (1999).

After *Kaestner*, what we know for certain is that, if a beneficiary has no control over trust income, the state where the beneficiary resides, but which has no other connection whatsoever with the trust, can't tax the trust's undistributed income but that distributed income can be taxed (as decided in *Maguire* noted above). How Kaestner might apply to cases with different facts remains to be seen and, almost certainly, litigated. Does the Court's refusing to hear Fielding mean that taxation based on settlor residence – whether he is dead or alive – is itself dead? What if a state uses a multi-factor test, such as beneficiary residence plus settlor residence? Kaestner is a decisive, albeit narrow, pronouncement. Unfortunately, it is far from either a law review article or a roadmap.

3. Termination of Trust Results In Capital Gains. In PLR 201932001 the IRS considered the termination of a trust along actuarial lines. The facts presented were:

> On Date 1, a date prior to September 25, 1985, Settlor created an irrevocable trust, Trust, for the benefit of Son. The material purpose of Trust was to ensure that Son receive an income stream for his support. Under the terms of the Trust agreement, the trustees are required to distribute all of the net income of Trust to Son, and, upon his death, distribute the remainder to his issue, per stirpes. The Trust agreement does not authorize any distributions of principal during Son's life. Son has four living adult children (Current Remaindermen) and eight living grandchildren, four of whom are adults (Successor Remaindermen). None of Son's descendants has a predeceased child with living issue. Son and Bank are currently serving as co-trustees of Trust.
>
> State Statute provides, in relevant part, that matters that may be resolved by a nonjudicial settlement include termination of the trust, provided that court approval of such termination is obtained in accordance with this section, and the court must conclude that continuance of the trust is not necessary to achieve any material purpose of the trust. State Statute further provides that upon such termination, the court may order the trust property distributed as agreed by the parties to the agreement or otherwise as the court determines is equitably consistent with the purposes of the trust.
>
> On Date 2, Son, the Current Remaindermen and the Successor Remaindermen entered into Agreement. Agreement states that the continuance of Trust "is no longer necessary to achieve any clear material purpose of such trust because [[Son]'s net worth has grown significantly, such that he does not need income from [Trust] for his support." Agreement further provides for the termination of Trust and the distribution of Trust's assets among Son, the Current Remaindermen and the Successor Remaindermen in accordance with the actuarial value of each beneficiary's share (Proposed Distribution).,

The IRS concluded that the transaction was in substance a sale. The ruling states:

> Rev. Rul. 72-243, 1972-1 C.B. 233, provides that the proceeds received by the life tenant of a trust, in consideration for the transfer of the life tenant's entire interest in the trust to the holder of the remainder interest, are treated as an amount realized from the sale or exchange of a capital asset under § 1222. The right to income for life from a trust estate is a right in the estate itself. See McAllister v. Commissioner, 157 F.2d 235 (2d Cir. 1946), cert. denied, 330 U.S. 826 (1947).
>
> In Rev. Rul. 69-486, 1969-2 C.B. 159, a non-pro rata distribution of trust property was made in kind by the trustee, although the trust instrument and local law did not convey authority to the trustee to a make a non-pro rata distribution of property in kind. The distribution was effected as a result of a mutual agreement between the trustee and the beneficiaries. Because neither the trust instrument nor local law conveyed authority to the trustee to make a non-pro rata distribution, Rev.

> Rul. 69-486 held that the transaction was equivalent to a pro rata distribution followed by an exchange between the beneficiaries, an exchange that required recognition of gain under § 1001.
>
> Although the proposed transaction takes the form of a distribution of the present values of the respective interests of Son, the Current Remaindermen, and the Successor Remaindermen, in substance it is a sale of Son's and the Successor Remaindermen's interests to the Current Remaindermen. Rev. Rul. 69-486.
>
> The amounts received by Son as a result of the termination of Trust are amounts received from the sale or exchange of a capital asset to the Current Remaindermen. Rev. Rul. 72-243. Because Son's basis in the income interest of Trust is a portion of the entire basis of the property under § 1015(b), and because the disposition of Son's term interests is not part of a transaction in which the entire interest in Trust is transferred to a third party, Son's adjusted basis in Son's interest in Trust is disregarded under § 1001(e). Son's holding period in the life interests in Trust exceeds one year. Accordingly, based on the facts submitted and representations made, the entire amount realized by Son as a result of the early termination of Trust will be long-term capital gain under § 1222(3).
>
> Similarly, the amounts received by the Successor Remaindermen as a result of the termination of Trust are amounts received from the sale or exchange of a capital asset to the Current Remaindermen. <u>Cf. Helvering v. Gambrill</u>, 313 U.S. 11, 15 (1941), 1941-1 C.B. 364 (The phrase "property held by the taxpayer" under a prior law holding period rule relating to capital gains and losses includes not only full ownership, but also any interest owned whether vested, contingent, or conditional). The Successor Remaindermen's holding period in their interests in Trust also exceeds one year. Accordingly, under § 1222(3), the gain determined under § 1001(a) by the Successor Remaindermen as a result of the early termination of Trust will be long-term capital gain.
>
> In addition, to the extent that a Current Remainderman exchanges property, including property deemed received from Trust, for the interests of Son and the Successor Remaindermen, the Current Remainderman will recognize gain or loss on the property exchanged. Accordingly, based on the facts submitted and representations made, for purposes of determining gain or loss, the amount realized by each Current Remainderman on the exchange of property for Trust interests held by Son and the Successor Remaindermen will be equal to amount of cash and fair market value of the trust interests received in exchange for the transferred assets. Section 1.1001-1(a) and Rev. Rul. 69-486.

Interestingly, the taxpayer <u>asked</u> for the "sale" ruling, perhaps to ensure it was "at least" a capital transaction. Suppose the parties had amended the trust to add principal distribution provisions. Would that have been a gift by the consenting parties, even prior to an actual distribution? Would that have altered the result of the ruling?

As discussed elsewhere in these materials, another potential strategy would be to cause the trust to terminate by operation of law. That could occur if all of the beneficial interests in the trust were contributed to an LLC (and if the LLC or the managers of the LLC were also trustees of the trust).

4. <u>No Income Tax Benefit From Revocable Trust, Even Indirectly</u>.. In <u>Heiting v. United States</u>, 2020 WL 374468 (W.D. Wis. 2020) the taxpayer's <u>revocable</u> trust held some stock which the trustee sold. The trust provided that stock was not to be sold, so the trustee bought it back. The taxpayers had paid income tax on the gain so now wanted a credit on their next year's income tax return under the claim of right doctrine. The court denied the credit because the trust was revocable and thus the prohibition on sale and the repurchase were not mandatory. The opinion states:

> The Heitings argue that the trustee was not authorized to sell the stock in the first place, so the trustee had a legal obligation to use the proceeds of the sale to repurchase the stock. The trustee's legal obligation, the argument goes, should be imputed to the Heitings because tax law treats the Heitings, not the trust, as the owner of the trust's assets. Dkt. 20, at 7. Furthermore, according to the Heitings, they could not ignore a breach of the trust agreement and profit from it. The basic principle of the Heitings' argument is that, for IRS purposes, a grantor trust is disregarded and the Heitings and their trust are, essentially, one in the same.
>
> The Heitings are correct that a grantor trust is disregarded for purposes of income tax. But the Heitings' argument is fundamentally unsound as a matter of trust law.
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> Neither the trustee nor the Heitings were actually obligated to repurchase the BMO and Fidelity shares. Under the Wisconsin Trust Code, "[w]hile a trust is revocable, the trustee may follow a direction of the settlor that is contrary to the terms of the trust." Wis. Stat. § 701.0808(1). So the Heitings, without amending the trust, could have instructed the trustee to do anything with the proceeds of the stock sale. Under the trust agreement itself, the trustee had to follow the Heitings' directions in taking any action regarding BMO and Fidelity stock—not only in selling it, but in buying it back as well. See Dkt. 11, Article IX, Article X. And, by the terms of the trust agreement, the Heitings could have amended or revoked the trust at any time, as they did in 2016.

5. Where HEMS Standard Ignored, A Trustee May Have A Section 678 Right to Withdraw. United Food and Commercial Workers Unions and Participating Employers Pension Fund v. Magruder Holdings, Inc., 2019 WL 1409725 (D. Maryland 2019), is an ERISA case dealing with attribution of stock through grantor trusts. At issue was whether section 678 applied to trusts subject to an ascertainable standard. The court held that because the standard was ignored by the family trustees section 678 applied: the trustees had a right to withdraw, in effect.

B. CHARITABLE AND TAX-EXEMPT MATTERS - Sections 170, 642, 664, 501, 509, 2055, 2522, and 4940-4947

1. Charitable Distributions From Trusts. Suppose a trust does not provide for distribution to charity but the beneficiaries desire such distributions to occur. If the trust is modified validly under state law to allow charitable distributions, will that allow the trust to take a section 642(c) deduction? In CCA 201651013 the IRS concluded no because the trust after modification was not the "governing instrument." The ruling states:

> In Old Colony Trust Company v. Commissioner, 57 S.Ct. 813 (1937), the Supreme Court reversed a decision of the First Circuit (87 F. 2d 131). A trust document authorized but did not require the trustees to make current charitable payments if they could do so without jeopardizing the payment of annuities from the trust to non-charitable beneficiaries. The Board of Tax Appeals denied most of the income tax charitable deduction under the predecessor of § 642(c)(1) because it found that the taxpayer had not met its burden of proof regarding whether most of the payments were actually made from trust income during the year made. The First Circuit denied the entire deduction because the charitable payments were "not imperatively directed" by the trust. If the trustee exercised discretion in making the payments, they were not "pursuant to" the terms of the trust. The Supreme Court referred to the plain dictionary meaning of "pursuant to" as "acting or done in consequence or in prosecution (of anything), hence, agreeable; conformable; following; according," which standard was met by the authorization in the trust instrument.
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> In Crown Income Charitable Fund v. Commissioner, 8 F.3d 571, 573 (7th Cir. 1993), *aff'g* 98 T.C. 327 (1992), the Seventh Circuit addressed the issue of commutation. The trust at issue in Crown contained a provision permitting the trustees to commute the charitable interest only if, as a matter of law, it was clear that doing so would not adversely affect the maximum charitable deduction otherwise available. The trustees of the Crown Income Charitable Fund distributed trust assets in excess of the annuity amount to the charitable beneficiary over a number of years and deducted, under § 642(c), the full amount distributed to the charitable beneficiaries. Both the Seventh Circuit and the Tax Court held that the excess distributions were not deductible under § 642(c) because those instruments were not made pursuant to the terms of the governing instrument.
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> In Brownstone v. United States, 465 F.3d 525 (2nd Cir. 2006), a deceased husband's will created a marital deduction trust, which granted the husband's surviving wife a general testamentary power of appointment. When the wife died, she exercised her power in favor of her estate, the residue of which passed to charitable organizations. The trustee of the marital deduction trust distributed $1 million to the wife's estate and claimed a charitable contribution deduction under § 642(c), because the $1 million distribution passed entirely to the charitable beneficiaries under the wife's will.

> The Second Circuit in Brownstone held that the distribution to the charities was made pursuant to the wife's power of appointment and not pursuant to the governing instrument, the deceased husband's will. The Second Circuit interpreted the definition of governing instrument narrowly, stating that an instrument subject to the creating instrument (the wife's will) could not combine with the creating instrument (the husband's will) and qualify as the governing instrument. The sole governing instrument in Brownstone was the husband's original will; therefore, the marital deduction trust was not entitled to a deduction under § 642(c) since the distribution was made pursuant to the wife's will.
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> In Lyeth v. Hoey, 305 U.S. 188 (1938), the Supreme Court held that property received in the settlement of a bona fide will contest is treated for federal income tax purposes as passing to the beneficiaries by inheritance. In Middleton v. United States, 99 F.Supp. 801 (D.C. Pa. 1951), the court held, applying principles derived from Lyeth, that amounts distributed to a charity pursuant to an agreement compromising a will contest were made "pursuant to the terms of the will." The court concluded that the income from the property that was distributed to the charity was permanently set aside for a charitable purpose and allowed a deduction for these amounts for the years prior to the year that the parties entered into the settlement agreement. See also Estate of Wright v. United States, 677 F.2d 53 (9th Cir. 1982), cert. denied, 459 U.S. 909 (1982).
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> In Emanuelson v. United States, 159 F.Supp. 34 (D.C. Conn. 1958), decedent left two conflicting wills -- one which left 2/3 of the residue of decedent's estate to certain charities, and another which left the entire residue to non-charitable legatees. After decedent's death, a controversy arose among the beneficiaries of the two wills. The controversy was resolved in a written compromise agreement between the two sets of beneficiaries, under which 52/480 of the residue passed to the charities named in one of the wills. Payments made to the charities under the written compromise agreement were held to be made pursuant to the will. Rev. Rul. 59-15, 1959-1 C.B. 164, citing Emanuelson, held that a settlement agreement arising from a will contest qualifies as a governing instrument.
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> In the current case, the taxpayer makes a summary argument that the payments qualify under § 642(c) because they are pursuant to the governing instrument, citing to Old Colony. They do not address the authorities concerning deductions under modified trust instruments. Here there was no conflict with respect to Trust B subsequent to the division of Parent Trust. The trust terms were unambiguous. The purpose of the court order was not to resolve a conflict in Trust B but to obtain the economic benefits which the parties believe they will receive from the modification of the Parent Trust. Neither Rev. Rul. 59-15 nor Emanuelson hold that a modification to a governing instrument will be construed to be the governing instrument in situations where the modification does not stem from a conflict of some sort. Additionally, both Crown and Brownstone have a narrow interpretation of what qualifies as pursuant to a governing instrument. Therefore, any payments to Foundation 1 and Foundation 2 after the modification of Trust B would not be considered to be made pursuant to the governing instrument, and Trust B is not entitled to a deduction for such payments under § 642(c).

The IRS also held that a 661, DNI, deduction would not be available. This result is controversial as the ruling notes. Commentators are divided, for instance:

> One standard treatise supports them on two policy grounds: "All of the courts but one [U.S. Trust District Court] that have considered this issue have sustained these regulations, even though they substantially exceed the scope of the statutory

language . . . The cases supporting the regulations take the appropriate view because a contrary rule has the effect of giving both an estate tax deduction (for the charitable disposition) and an income tax deduction (for the item distributed to charity) for the same payment. "Also, as a result of deducting distributions of corpus to charity, the non-charitable legatees in effect receive the estate's income tax-free. The benefit of the income tax deduction inures to the noncharitable legatees, rather than to the charity, so the court decisions favoring the regulation seem fundamentally sound." [citations omitted] Danforth, Robert T., et al., Federal Income Taxation of Estates and Trusts [current through 2016], at 4.07[1]

However, at least as many secondary sources in this area disagree with the disallowance under § 661(a), at least under some facts. Another standard treatise, Ferguson, M. Carr, et al, Federal Income Taxation of Estates, Trusts, & Beneficiaries (current through 2016), states at § 6.10: "The analysis [explaining why a single payment should not allow double deduction under §§ 642(c) and § 661(a)] does not, however, answer the question whether amounts that pass to charity in such a way as not to qualify for the deduction under § 642(c), such as amounts that pass to nonqualified quasi-charitable organizations or are used for purposes that are not exclusively charitable, escape the proscription of § 663(a)(2). Obviously, such amounts do *not* qualify 'for the deduction provided in § 642(c).' Are they therefore deductible as distributions under § 661? A literal reading of the statute strongly suggests that many such amounts should be. Even an undisputedly charitable beneficiary would be treated the same as any other beneficiary under the distribution rules, if it were not for §§ 642(c) and 663(a)(2). When no deduction is available under § 642(c), § 663(a)(2) seems to plainly not apply."

The regulations and history only add to the confusion:

Section 1.663(a)-2 provides that any amount paid, permanently set aside, or to be used for the charitable, etc., purposes specified in § 642(c) and which is allowable as a deduction under that section is not allowed as a deduction to an estate or trust under § 661 or treated as an amount distributed for purposes of determining the amounts includible in gross income of beneficiaries under § 662. **Amounts paid, permanently set aside, or to be used for charitable, etc., purposes are deductible by estates or trusts only as provided in § 642(c).** For purposes of this section, the deduction provided in § 642(c) is computed without regard to the provisions of §§ 508(d), 681, or 4948(c)(4). [emphasis added]

Section 663(c) provides that for the sole purpose of determining the amount of DNI in the application of §§ 661 and 662, in the case of a single trust having more than one beneficiary, substantially separate and independent shares of different beneficiaries in the trust shall be treated as separate trusts. Rules similar to the rules of the preceding provisions of § 663(c) shall apply to treat substantially separate and independent shares of different beneficiaries in an estate having more than one beneficiary as separate shares. The existence of such substantially separate and independent shares and the manner of treatment as separate trusts or estates, including the application of subpart D [the "throwback" rules of §§ 665-668], shall be determined in accordance with regulations prescribed by the Secretary.

Sections 661(a), 663(a)(2), and 663(c) were enacted as part of the original Internal Revenue Code of 1954. The only subsequent change relevant to the current issue was the amendment of § 663(c) by § 1307 of the Taxpayer Relief Act of 1997, P.L. 105-34, to apply to estates as well as trusts. Section 642(c), discussed under

Issue 1, was also included in the original Code, and was bifurcated by § 201 of the Tax Reform Act of 1969, P.L. 91-172, into current §§ 642(c)(1) and (2), dealing respectively with deductions for current payments to charity and deductions for amounts "permanently set aside" for later payment.

The 1954 legislative history is not entirely clear on the purpose and scope of § 663(a)(2). Whereas the charitable and distribution deduction provisions had general counterparts under the 1939 Code (§§ 162(a) and (b), respectively), § 663(a)(2) was a new provision, as was the entire DNI mechanism. In general, under the 1939 Code, distribution deductions had to be actually traced to the trust's gross income, whereas such tracing is unnecessary under the 1954 and 1986 Codes, since § 661 distributions automatically take out DNI which then is generally taxable under § 662 to the beneficiaries. The tracing requirement formerly applying to all trust and estate distributions now only survives for the charitable deduction under § 642(c).

The House and Senate Reports on the 1954 Code (H.R. 8300) each explain the exclusion of § 642(c) amounts from §§ 661 and 662 with reference to the "additional" deduction which the entity would be able to claim if not for this provision, suggesting that § 663(a)(2) is meant simply as an anti-duplication measure, not that there is an underlying policy of § 642(c) exclusivity.[4] The American Bar Association's submission regarding the bill also supports the adoption of this provision as preventing an "additional" deduction for distributions for which a deduction would already be allowed under proposed § 642(c). See Senate Finance Comm. Hearings on H.R. 8300, 83d Cong., 2d Sess. 438[5]

However, the example in the Senate Report demonstrating the application of §§ 661-663 (S. Rep. 1622 at 351-353) suggests the opposite interpretation. The terms of a testamentary trust require that half of the trust income be distributed currently to the grantor's wife for life. The remaining half in the trustee's discretion may either be paid to the grantor's daughter, paid to designated charities, or accumulated. At the wife's death, the entire trust principal will be payable to the daughter. In the given year, the trust income consisted of dividends, rentals, and tax-exempt interest, of which the trustee distributed half to the wife and one-quarter each to the daughter and a charity. In determining the § 661(a) distribution deduction, the example excludes the amount distributed to the charity since it was allowed as a deduction under § 642(c) to the extent that it was included in the trust's gross income. However, the entire amount paid to the charity is not deductible under § 642(c) because a ratable part of it is attributable to the tax-exempt interest which does not enter into gross income and thus fails one prong of the § 642(c) test. The example does not add the disallowed portion of the charitable payment back into § 661 for determining the distribution deduction, thus indicating that payments to charity are deductible, if at all, only under § 642(c). The example in the Senate Report was substantially adopted as the example illustrating §§ 661-662 in § 1.662(c)-4. That section and § 1.663(a)-2 were both published as part of the original subchapter J regulations, T.D.6217 (12/19/56). The latter originally only referred to limits on charitable deductions under § 681, and was later amended to include the limits under §§ 508(d) and 4948(c)(4) added by the 1969 Act.

The taxpayer attempted to inspire the IRS to accept a bona fide state court modification to the trust instrument as being the "governing instrument" but the IRS rejected inspiration in CCA 201747005. The taxpayer and the IRS settled the case but the IRS did not concede the point.

There is no evidence that this is part of a larger exercise to limit the tax effect of prospective state court modifications (for instance, adding general power for basis). If a trust cannot be effectively amended, what can be done to obtain a charitable deduction for trust income? The assets of the trust could be contributed to an S corp. and the trust could become an ESBT (see discussion of the 2017 Tax Act). Or, distributions could be made to a 501(c)(4) organization, for which a section 661 deduction is allowable. A third way is that Rev. Ruling 2004-05 may help.

Gifts by partnerships or LLCs are deductible proportionately by the partners or members. IRC § 702(a)(4). Rev. Rul. 96-11 holds that when a partnership makes a charitable contribution of property, the basis of each partner's interest in the partnership should be decreased, but not below zero, by the partner's share of the partnership's basis in the property contributed. Similarly, a partner's charitable deduction for the contribution of appreciated property by the partnership does not seem to be limited to her share of the partnership's basis in the assets. See Private Letter Ruling 8405084. Thus, contributions of appreciated property by partnerships preserve the tax benefit of receiving a deduction at fair market value for the contribution of appreciated property; the unrealized appreciation is not transferred to the partner's interest in the partnership.

Rev. Rul. 2004-05 provides that a trust which is a partner will benefit from a charitable contribution made by the partnership even if the trust itself has no charitable beneficiaries. The Ruling does not state how the trust came to be a partner. May a trust with no charitable beneficiaries become a partner in a partnership which allows charitable contributions without the consent of the trust partner? Presumably the answer is yes so long as the beneficiaries are agreeable. See also Private Letter Ruling 200208019, in which the IRS considered whether the members of a partnership were entitled to a charitable deduction on account of the partnership's grant of a conservation easement to a charitable organization. The IRS concluded that each partner was entitled to a charitable deduction equal to each partner's distributive share of the gift. A trust could <u>not</u> benefit from that deduction because §642(c) allows only deductions for income.

PLR 201225004 involved a trust claiming the section 642(c) deduction for income distributed to charity and the requirement that the income be distributed "pursuant to the terms of the governing instrument." Here, the distribution was directed by a beneficiary's exercise of a lifetime special power of appointment and the IRS determined that satisfied the "pursuant to" requirement even though the governing instrument did not specify a charitable bequest. It only authorized exercise of the power in favor of charity. In PLR 9821029, an individual exercised a lifetime nongeneral power of appointment over a trust to create a charitable remainder trust for a term of years with the trust as the unitrust beneficiary. The IRS allowed the trust to be the beneficiary and allowed the charitable remainder trust to be created by the exercise of the power.

If a charity is given the right to withdraw a portion of the income and gains from a trust then the charity is the owner of that portion under section 678 which avoids the need for a section 642(c) deduction. This is a "BDOT solution" (see discussion of BDOTs).

The meaning of "income" for purposes of section 642(c) was presented in Green v. United States, 880 F.3d 519 (10th Cir. 2018). The trust in question had used business earnings – distribution from a partnership – to purchase real estate. The real estate appreciated and was contributed to charity. Was the charitable deduction available to the trust the basis of the property or the appreciated value, the fair market when contributed? Surprisingly, the District Court held for the taxpayer, giving the trust a fair market value deduction. As expected, the Tenth Circuit reversed, holding for the government:

> As an initial matter, the IRS asserts, and the Trust agrees, that the statutory phrase "any amount of the gross income" means that charitable donations must be made out of a trust's gross income, but that real property purchased with gross income can also be treated as the equivalent of gross income for purposes of the deduction outlined in § 642(c)(1). This, we conclude, is an entirely reasonable interpretation of the statutory language. More specifically, this interpretation is consistent with the statutory language, and also encourages charitable donations to a greater degree than an interpretation that fails to include a sourcing component, i.e., an interpretation that limits the deduction to donations made exclusively from gross income.4 See Old Colony, 301 U.S. at 384 ("Congress sought to encourage donations out of gross income . . . .").
>
> That still leaves open the question of the allowable amount of a deduction for donated real property that was purchased with a taxpayer's gross income. The IRS has consistently asserted, both in addressing the Trust's claim for a refund and in this litigation, that the deduction amount is limited to the taxpayer's adjusted basis in the donated real property, i.e., the amount of gross income the taxpayer originally paid for the real property. Without granting any deference to the IRS's position, we conclude that it is the most reasonable interpretation of the statutory language, particularly when considered in light of the Code as a whole.
>
> ***
>
> As the IRS correctly notes in this case, because the Trust never sold or exchanged the properties at issue, it never realized the gains associated with their increases in market value and was therefore never subject to being taxed on those gains. Thus, construing § 642(c)(1)'s deduction to extend to unrealized gains would be inconsistent with the Code's general treatment of gross income. Consequently, unless and until Congress acts to make clear that it intended for the § 642(c)(1) deduction to extend to unrealized gains associated with real property originally purchased with gross income (similar to what Congress did in § 170, which, as we have noted, addresses charitable contributions by individuals and corporations), we conclude that we cannot construe the deduction in that manner.
>
> Finally, we note that this interpretation finds support in a leading tax treatise, see 9 MERTENS LAW OF FEDERAL INCOME TAXATION, § 36:75 (Eric D. Roth ed., Dec. 2017) ("Where appreciated property purchased from accumulated gross income is donated, the amount of the deduction is limited to the adjusted basis of the property, rather than based on the fair market value of the donated property."), as well as, at least in part, an older Third Circuit case dealing with § 642(c)(1)'s predecessor statute. See W. K. Frank Trust of 1931 v. Comm'r, 145 F.2d 411, 413 (3d Cir. 1944) (holding that the appreciated value of shares of donated stock, which was the result of them being "worth more on the market when the gift was made than . . . when the trust got them," "was not gross income").

2. Use of Section 501(c)(4) Organizations to Facilitate Business Interest Ownership. Under the Protecting Americans from Tax Hikes Act of 2015, Section 2501(a) was amended to specifically exclude from federal gift tax "transfers of money or other property to an organization described in paragraph (4), (5), or (6) of section 501(c) and exempt from tax under section 501(a), for the use of such organization." This exclusion from federal gift tax is applicable to lifetime gifts to section 501(c)(4), (5), and (6) organizations, but does not apply to transfers at death. Accordingly testamentary transfers to section 501(c)(4), (5), and (6) organizations still would be taxable for estate tax purposes. Moreover, lifetime transfers to these organizations also could be subject to IRC § 2036. No private inurement is permitted for a section 501(c)(4) organization. Effective July 19, 2019, are final regulations under section 506 dealing with the requirement that an organization notify the IRS within 60 days of its intent to operate under section 501(c)(4). TD 9873.

Section 501(c)(4) Organizations include "civic leagues" and "social welfare organizations," which must be nonprofit and organized for the promotion of the common good and general welfare of the community as a whole, and "local associations of employees," in which membership is limited to employees of a particular person or particular person in a designated locality, and the earnings of which must be used for charitable, educational or recreational activities. Specific examples of section 501(c)(4) organizations would be homeowners associations, veterans groups, community centers and community programs, volunteer fire departments, parks associations, public recreational facilities, and service organizations.

A section 501(c)(4) organization does not appear to fit within the definition of "disqualified person," because it is:

- Not a substantial contributor or foundation manager;
- Not an individual
- Not a "35 percent" corporation, partnership, trust or estate; and
- Not a private foundation.

No cases or rulings appear to establish that a section 501(c)(4) organization would be a disqualified person. This may create a useful opportunity to use section 501(c)(4) organizations to avoid excess business holdings and self-dealing issues that could arise from transfers of closely-held business interests to a private foundation.

Section 4943 would preclude a private foundation from long-term ownership of more than 20 percent of the voting stock of a corporation or other business enterprise in combination with all disqualified persons. However, if a section 501(c)(4) organization is not a disqualified person, it could own a "business enterprise" with one or more private foundations in a manner that would avoid violating the prohibition against excess business holdings under section 4943. If an owner transferred interests in a closely-owned business to a private foundation in conjunction with a transfer to a section 501(c)(4) organization, it may be possible to avoid excess business holdings.

To illustrate,

- Donor could recapitalize her closely-held business enterprise from 1 million shares of common stock to 100,000 shares of voting stock and 900,000 shares of nonvoting stock.

- Donor then could contribute 80,000 shares of voting stock to a new section 501(c)(4) organization that Donor's family controls, without incurring gift tax.

- At death, Donor could contribute 20 percent of voting stock and all nonvoting stock to a private foundation, and the section 501(c)(4) organization would own 80 percent of the voting stock.

If a section 501(c)(4) organization is not a disqualified person (even if it is controlled by one or more disqualified persons) it would be permissible for a private foundation and the section 501(c)(4) organization to enter into transactions that ordinarily would be treated as self-dealing. For example a section 501(c)(4) organization could:

- Purchase or borrow assets from a related private foundation.

- Lease real estate to a related private foundation.

- Co-own and co-invest with a related private foundation.

3. **<u>Estate Income Tax Deduction</u>**. Where a decedent lacks a taxable estate, but wants to make a charitable bequest, consideration should be given to providing that the first dollars of income of the estate go to charity in an amount equal to the amount of the bequest. The estate will receive an income tax deduction if the estate has sufficient income.

4. **<u>Conservation Easement Controversy</u>**. In addition to the cases noted in these CLE materials, the Tax Court has handed down more than a dozen government victories along the same grounds. On June 25, 2020, in IR-2020-130 the IRS announced a "time-limited settlement offer" to taxpayers with cases pending in Tax Court. The IRS position is that it will not negotiate syndicated easements so promoters pay full penalties (40%) but taxpayers may make themselves eligible for a 10% - 20% penalty if they settle cooperatively, but the benefits of the deduction will be lost (a taxpayer may deduct acquisition cost of the land). Taxpayers who are not in syndicates but whose easements are defective on technical grounds are in a bit of a no-man's land. By way of background, the IRS has been very grumpy with syndicated easements for several years. Notice 2017-10 states:

> The Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) are aware that some promoters are syndicating conservation easement transactions that purport to give investors the opportunity to obtain charitable contribution deductions in amounts that significantly exceed the amount invested. This notice alerts taxpayers and their representatives that the transaction described in section 2 of this notice is a tax avoidance transaction and identifies this transaction, and substantially similar transactions, as listed transactions for purposes of §1.6011-4(b)(2) of the Income Tax Regulations (Regulations) and §§6111 and 6112 of the Internal Revenue Code (Code).

The specific transaction covered by the Notice is described as follows:

> An investor receives promotional materials that offer prospective investors in a pass-through entity the possibility of a charitable contribution deduction that equals or exceeds an amount that is two and one-half times the amount of the investor's investment. The promotional materials may be oral or written. For purposes of this notice, promotional materials include, but are not limited to, documents described in §301.6112-1(b)(3)(iii)(B) of the Regulations. The investor purchases an interest, directly or indirectly (through one or more tiers of pass-through entities), in the pass-through entity that holds real property. The pass-through entity that holds the real property contributes a conservation easement encumbering the property to a tax-exempt entity and allocates, directly or through one or more tiers of pass-through entities, a charitable contribution deduction to the investor. Following that contribution, the investor reports on his or her federal income tax return a charitable contribution deduction with respect to the conservation easement.

The effect of the Notice is retroactive:

> Transactions entered into on or after January 1, 2010, that are the same as, or substantially similar to, the transaction described in section 2 of this notice are identified as "listed transactions" for purposes of §1.6011-4(b)(2) and §§6111 and 6112 effective December 23, 2016. Persons entering into these transactions <u>on or after January 1, 2010</u>, [emphasis added] must disclose the transactions as described in §1.6011-4 for each taxable year in which the taxpayer participated in the transactions, provided that the period of limitations for assessment of tax has not ended on or before December 23, 2016.
>
> Material advisors, including appraisers, who make a tax statement on or after January 1, 2010, with respect to transactions entered into on or after January 1, 2010, have disclosure and list maintenance obligations under §§6111 and 6112. See §§301.61113, 301.6112-1.
>
> For rules regarding the time for providing disclosure of a transaction described in this notice, see §§1.6011-4(e) and 301.6111-3(e). However, if, under §1.6011-4(e)(1), a taxpayer is required to file a disclosure statement with respect to a transaction described in this notice after December 23, 2016, and prior to May 1, 2017, that disclosure statement will be considered to be timely filed if the taxpayer alternatively files the disclosure with the Office of Tax Shelter Analysis by May 1 (because April 30 is a Sunday). In addition, for purposes of disclosure of transactions described in this notice, the 90-day period provided in §1.6011-4(e)(2)(i) is extended to 180 days. Further, if under §301.6111-3(e), a material advisor is required to file a disclosure statement with respect to the listed transaction described in this notice by January 31, 2017, that disclosure statement will be considered to be timely filed if the taxpayer files the disclosure with the Office of Tax Shelter Analysis by May 1, 2017 (because April 30 is a Sunday).

On June 27, 2019, the Congressional Research Service issued a white paper titled <u>Charitable Conservation Contributions Potential for Abuse</u>? Easements declined in 2009–13 but substantially increased in 2014-15.

Independently, a committee of the American Bar Association has issued a report, the <u>ABA RPTE Conservation Easement Task Force: Recommendations Regarding Conservation Easements and Federal Tax Law</u>.

(Available via SSRN at https://ssrn.com/abstract=3385453 or 53 Real Property, Trust and Estate Law Journal, Fall 2018/Winter 2019).

In a July 31, 2019 letter to a taxpayer who had written to Senators Isakson and Perdue, Chief Counsel Michael Desmond stated:

> Your letter accurately notes that the IRS believes that significant abuse of the conservation easement deduction continues to exist, particularly overvaluation of easements. Overvaluations pose a vexing and persistent problem, which the IRS addresses in Treasury Regulation section 1.170A-17 and in the syndicated conservation easement listing notice, Notice 2017-10.
>
> The IRS has made overvalued easements an enforcement priority. IRS examiners are trained to look for overvaluation indicators, which are nearly always the primary reason for commencing a conservation easement deduction audit.
>
> Easement donors who rely on appraisers with extensive professional qualifications and experience may in good faith believe that the appraisals they prepare contain correct conclusions of value and comport with statutory and regulatory requirements. At times, however, the reliance is misplaced. When appraisals look too good to be true, taxpayers who rely on them are taking a risk.

5. Unspecified Building Lot Locations Dooms Conservation Easement Deduction. In Pine Mountain Preserve LLLP et al. v. Commissioner, 151 T.C. No. 14 (2018), the primary issue was whether the ability to construct residences in various building areas invalidated a conservation easement. The taxpayer (Pine Mountain Preserve LLLP) conveyed to the North American Land Trust (NALT) in 2005, 2006, and 2007, easements covering relatively small portions of land in Alabama. Each easement defined a conservation area that was to be restricted in perpetuity from commercial and residential development, with a carve-out in the 2005 and 2006 easements for 16 reserved "building areas," within each of which the taxpayer could construct a single-family residence. The 2006 easement did not specify the location of the building areas, and the 2005 easement permitted the taxpayer, with the consent of the land trust, to move the building areas from their initially designated locations to any other location within the conservation area.

The opinion states:

> We begin with the 2006 easement because it presents a somewhat novel pattern. The 2006 easement permits Pine Mountain to establish within the 2006 Conservation Area six Building Areas, each as large as one acre. Each Building Area may include a single-family dwelling plus "a shed, garage, gazebo, and pool," and the owner of each Building Area may construct a 5,000-square-foot barn within 1,000 feet of its perimeter. However, the 2006 easement does not specify, either in the deed itself or in an attached plat, the locations of the six Building Areas. And it places no limitations on where within the 2006 Conservation Area such Building Areas may be located, except to say that these locations must be "approved in advance" by NALT.
>
> It seems clear to us that the 2006 easement does not embody "a restriction (granted in perpetuity) on the use which may be made of the real property." See sec.

170(h)(2)(C). Although the restriction placed by the easement is perpetual, "the restriction on 'the real property' is not." Belk III, 774 F.3d at 226 (quoting section 170(h)(2)(C)). Pine Mountain remained free to build a six-acre residential development within the 2006 Conservation Area, thus converting to commercial use land that was supposed to be protected in perpetuity from development. Indeed, it was impossible to define, when the 2006 easement was granted, what "real property" would actually be restricted from development, because the residential lots could literally be placed anywhere within the 2006 Conservation Area. As a result, the perpetual use restriction did not attach at the outset "to a defined parcel of real property" or to "a single, immutable parcel" of land. Id. at 225, 227.

NALT had to approve the precise location of the six residences within the 2006 Conservation Area. By so doing, NALT might minimize the derogation of conservation values that the subdivision caused and perhaps ensure that "the conservation purpose [wa]s protected in perpetuity." Sec. 170(h)(5)(A). But this does not change the fact that the easement, when granted, did not create a perpetual use restriction on a defined parcel of land, as required by section 170(h)(2)(C). Because the 2006 easement does not constitute a "qualified real property interest," Pine Mountain could not claim for the donation of this interest a charitable contribution deduction under section 170(f)(3)(B)(iii) and (h)(1).

2. 2005 Easement

Most of the 2005 Conservation Area consists of ridgelines and higher elevation land in the northwest portion of Parcel 2. The balance consists of lower lying land around a man-made lake near the center of Parcel 2. Overall the easement covers about 47% of the acreage of Parcel 2.

Apart from the acreages involved, the 2005 easement is substantially similar to the easements involved in Bosque Canyon. It reserves to Pine Mountain or individual homeowners the rights to construct one single-family dwelling and appurtenant structures within each of ten "Building Areas" inside the 2005 Conservation Area. Although the deed itself does not limit the size or location of these ten Building Areas, an attached plat shows each Building Area as a one-acre lot situated around the man-made lake.

Article 3.16, however, provides that the "boundaries of the Building Areas may be modified by mutual agreement" of Pine Mountain and NALT. Such modification is subject to the proviso that "the areas of a Building Area shall not be increased" and that the boundary modifications shall not, in NALT's "reasonable judgment," adversely affect conservation purposes. Article 3.16 thus permits the Building Areas to be relocated (with NALT's consent) to higher elevation zones or to other locations within the 2005 Conservation Area.

Besides permitting the relocation of homesites, the easement permits Pine Mountain to build within the 2005 Conservation Area other structures and facilities appurtenant to the residential development. These include:

• at least ten barns, each of which may include "an apartment for occupancy by a caretaker and such caretaker's family";

• two scenic overlooks, one of which "may include a guest bedroom," occupying up to six acres in the aggregate;

> • at least one riding stable and indoor riding ring, occupying up to ten acres in the aggregate;
>
> • up to 14 piers and boat launches, which may include four "common boat launch facilit[ies] with associated boat storage building[s]";
>
> • up to five ponds, occupying up to 25 acres in the aggregate, which may apparently be encumbered by piers and boat launch facilities; and
>
> • a reasonable (but otherwise unlimited) number of wildlife hunting stands or blinds to facilitate hunting and shooting by homeowners and their guests.
>
> The easement does not specify the location of any of these facilities, and their location could change if the location of the Building Areas changed. Although NALT's approval is generally required, its approval for certain facilities (such as the man-made ponds) "shall not be unreasonably withheld." For other facilities, such as the piers, boat launches, boat storage buildings, and hunting blinds, no approval or prior review by NALT is needed.
>
> We conclude that the rights reserved to Pine Mountain, considered in their entirety, prevent the 2005 easement from constituting a "qualified real property interest." See sec. 170(h)(2). As in Bosque Canyon, the easement deed allows all ten residences to be moved from the man-made lake to other, possibly more desirable, locations within the 2005 Conservation Area. And as in Bosque Canyon, the easement places no limits on how many homesites can be moved, how often this can be done, or how far into the future such relocations can occur.
>
> The 2005 easement also permits Pine Mountain to construct, anywhere within the 2005 Conservation Area, a variety of other buildings. At least 11 of these buildings may include additional living quarters. All of these facilities are intended for the recreational use of the homeowners and their guests. Collectively, they have the effect of expanding the residential development well beyond the ten acres consumed by the Building Areas alone.

A dissent would have been less restrictive but attracted only one vote.

See also Carter v. Commissioner, T.C. Memo. 2020-21, with the same result.

6. Sham and Lack of Economic Substance Arguments Apply When Considering Deduction. RERI Holdings I LLC et al. v. Commissioner, T.C. Memo. 2014-99, promises to be a fascinating case. A "successor membership interest" in a single member LLC was transferred to the University of Michigan. The appraised value was almost $33 million and the donor took that as an income tax deduction. The university held it for two years – per agreement – and then sold it for $1,940,000 to an entity owned indirectly by the donor. That entity immediately sold the interest for $3 million and the buyer donated the interest to another charity, claiming an income tax deduction of almost $30 million. The Tax Court denied the deduction and imposed a penalty.

RERI Holdings lost its appeal before the District of Columbia Court of Appeals. Blau v. Commissioner, 924 F. 3d 1261 (D. C. Cir. 2019). The IRS had concluded that the taxpayer had claimed an inflated value for the charitable deduction and that the failure of the taxpayer to supply the income tax basis of the donated property hampered the IRS' review of the transaction The opinion states:

> The valuation of approximately $33 million derives from an appraisal conducted by Howard Gelbtuch of Greenwich Realty Advisors, dated September 2003. As required by Treasury regulations, RERI attached the Gelbtuch appraisal to its return. RERI also completed a Form 8283 for Noncash Charitable Contributions; however, RERI left blank the space for "Donor's cost or adjusted basis." It did not provide any explanation for the omission.
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> After a four-day trial, the Tax Court issued a judgment sustaining both the IRS's determination that RERI was not entitled to any charitable contribution deduction and its assessment of the 40% penalty. The Tax Court, however, did not base its decision upon the "lack of economic substance" theory advanced by the IRS; instead, it concluded that RERI had failed to substantiate the value of the donated property as required by Treasury regulations. 149 T.C. at 17. Nonetheless, on its way to affirming the penalty for a gross valuation misstatement, the Tax Court found the SMI ["successor member interest"] was worth $3,462,886 on the date of the donation. The court also held RERI did not qualify for the "reasonable cause" exception to accuracy-related penalties. See IRC § 6664(c).
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> The IRS urges this court to affirm the Tax Court on the alternative theory that substantial compliance with the regulation does not suffice, so that RERI's failure to include the basis on Form 8283 was automatically fatal. RERI, for its part, does not dispute that it failed to supply its basis in the SMI and to provide an explanation for the omission. Instead, RERI maintains that the substantial compliance doctrine does apply here, and that providing its basis in the donated property is not necessary for compliance. It emphasizes that both the Second Circuit and the Tax Court have concluded the substantiation requirements can be satisfied by substantial compliance. See *Scheidelman v. Comm'r*, 682 F.3d 189, 199 (2d Cir. 2012); Bond, 100 T.C. at 40-41.
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> The Tax Court formulated the test for substantial compliance as "whether the donor provided sufficient information to permit the Commissioner to evaluate the reported contributions, as intended by Congress." 149 T.C. at 16 (quoting *Smith v. Comm'r*, 94 T.C.M. 574, 586 (2007), aff'd, 364 F. App'x 317 (9th Cir. 2009)). The IRS advocates a significantly more stringent test under which anything short of complete compliance is excused only if "(1)[the taxpayer] had a good excuse for failing to comply with the regulation *and* (2) the regulation's requirement is unimportant, unclear, or confusingly stated in the regulations or statute." The Fourth, Fifth, and Seventh Circuits have adopted this formulation of the substantial compliance standard, albeit for different provisions of the tax code. *See Volvo Trucks of N. Am., Inc. v. United States*, 367 F.3d 204, 210 (4th Cir. 2004); *McAlpine v. Comm'r*, 968 F.2d 459, 462 (5th Cir. 1992); *Prussner v. United States*, 896 F.2d 218, 224 (7th Cir. 1990).
>
> We conclude that, even if a taxpayer can fulfill the requirements of § 1.170A-13 through substantial compliance, RERI failed substantially to comply because it did not disclose its basis in the donated property; accordingly, we assume but do

> not decide that substantial compliance suffices. As we read the Tax Court's decision, a taxpayer must supply its basis (or an explanation for failing to do so) in order to "provide[] sufficient information to permit the Commissioner to evaluate the reported contributions, as intended by Congress." 149 T.C. at 16. If that is correct, and we think it is despite RERI's several arguments to the contrary, then we need not choose between the Tax Court's standard for substantial compliance and the IRS's more exacting one.

RERI argued that a blank is the same as zero so the IRS was alerted to the basis – fair market value gap. The Court said no:

> RERI contends in the alternative that the omission of a number in a tax filing is typically construed as a zero, and that a zero provides the same red flag as does an unusually low basis. The point would have some force had the Secretary not provided for the donor to substitute an explanatory statement if it is "unable" to provide information on the cost basis. § 1.170A-13(c)(4)(iv)(C)(1). Because a taxpayer may lack information about its basis, the IRS reasonably chose not automatically to treat a blank box as a zero. RERI did not lack information about its basis or have any other excuse for its failure to report its basis.

The next issue before the Court was whether its underpayment was attributable to the <u>valuation overstatement</u> because the Tax Court had held that it was the <u>absence of basis</u> that was the problem. No said the court:

> Recall that an accuracy-related penalty applies only to the "portion of the underpayment ... attributable to one or more gross valuation misstatements." § 6662(h)(1). RERI's second argument is that, even if it misstated the value of the donated property, its underpayment is not "attributable to" that misstatement within the meaning of the penalty statute because the Tax Court's stated reason for disallowing the deduction — which resulted in the underpayment — was RERI's failure properly to substantiate the donation per IRC § 170 and the associated regulations. This ground for the adjustment does not relate to a misstatement of the value of the contributed property. Subsequently, however, the Tax Court also determined the taxpayer misstated the value of the donated property. In these circumstances, is the underpayment fairly "attributable to" the valuation misstatement? Put another way, can an underpayment be attributable to two independent grounds for an adjustment?
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> Consistent with its own precedent, the Tax Court answered this question in the affirmative. 149 T.C. at 21 (citing *AHG Invs., LLC v. Comm'r*, 140 T.C. 73 (2013)). Because the proper interpretation of the phrase "attributable to" is a legal issue, we resolve the question de novo. *See Byers*, 740 F.3d at 675. For the reasons that follow, we agree with the Tax Court that an underpayment can be "attributable to" more than one cause if one of the causes is a misstatement of value.
>
> To begin, nowhere does the statute suggest there can be only a single cause for an underpayment. The phrase "attributable to" comfortably comprehends situations in which the IRS has multiple reasons for adjusting a charitable deduction. Moreover, as the First Circuit has recognized, RERI's reading of § 6662 has the perverse result of "allow[ing] the taxpayer to avoid a penalty otherwise applicable to his conduct on the ground that the taxpayer had also engaged in additional violations that would support disallowance of the claimed losses." *Fidelity Int'l Currency Advisor A Fund, LLC v. United States*, 661 F.3d 667, 673 (2011). A penalty is meant to deter and punish abuse of the tax laws; those purposes would

be frustrated if it were interpreted in such a way as to reward a taxpayer for committing multiple abuses. *See id*.

RERI nonetheless advances an argument based principally upon the Supreme Court's decision in *United States v. Woods*, 571 U.S. 31, 134 S.Ct. 557, 187 L.Ed.2d 472 (2013), which postdates the precedent upon which the Tax Court relied. In *Woods* the district court had concluded the taxpayers' partnerships lacked economic substance; it therefore disallowed deductions for losses generated by those partnerships. *Id.* at 37, 134 S.Ct. 557. The taxpayer argued that a penalty under § 6662 for misstatement of its basis did not apply because the underpayment was "attributable to" the lack of economic substance as opposed to the misstatement of its basis. *Id.* at 46-47, 134 S.Ct. 557. The Court rejected the argument because "the economic-substance determination and the basis misstatement are not 'independent' of one another." *Id.* at 47, 134 S.Ct. 557. On the contrary, they were "inextricably intertwined": "The partners underpaid their taxes because they overstated their outside basis, and they overstated their outside basis because the partnerships were shams." *Id.* (cleaned up).

RERI reads this decision to imply that, had the two grounds for disallowance been independent rather than "inextricably intertwined," the Court would not have upheld the penalty. That implication is unfounded: Having "reject[ed] the argument's premise," the Court did not reach Woods's claim that the underpayment was attributable only to one of the two "independent legal ground[s]." *Id.*

As RERI points out, however, the Fifth and Ninth Circuits have adopted its position. *See Todd v. Comm'r*, 862 F.2d 540, 542 (5th Cir. 1988); *Gainer v. Comm'r*, 893 F.2d 225, 228 (9th Cir. 1990). Like the First Circuit in *Fidelity* and the Federal Circuit in *Alpha I, L.P. ex rel. Sands v. United States*, 682 F.3d 1009 (2012), we regard the reasoning in those cases as flawed. Both cases relied upon the *General Explanation of the Economic Recovery Tax Act of 1981*, also known as the "Blue Book." *Todd*, 862 F.2d at 542-43; *Gainer*, 893 F.2d at 227-28. Prepared by the staff of the Joint Committee on Taxation, the Blue Book explains how to calculate a valuation misstatement penalty: "The portion of a tax underpayment that is attributable to a valuation overstatement will be determined after taking into account any other proper adjustments to tax liability." Staff of the J. Comm. on Taxation, 97th Cong., General Explanation of the Economic Recovery Tax Act of 1981, at 333 (Comm. Print 1981). In particular, *Todd* and *Gainer* focused upon the following example:

> Assume ... an individual files a joint return showing taxable income of $ 40,000 and tax liability of $ 9,195. Assume, further, that a $ 30,000 deduction which was claimed by the taxpayer as the result of a valuation overstatement is adjusted down to $ 10,000, and that another deduction of $ 20,000 is disallowed totally for reasons apart from the valuation overstatement. These adjustments result in correct taxable income of $ 80,000 and correct tax liability of $ 27,505. Accordingly, the underpayment due to the valuation overstatement is the difference between the tax on $ 80,000 ($ 27,505) and the tax on $ 60,000 ($ 17,505) ... or $ 9,800.

Id. at 333 n.2, quoted in *Todd*, 862 F.2d at 543, and in *Gainer*, 893 F.2d at 228 n.4. From this example, both courts concluded that, when there is another reason for disallowing a deduction, the taxpayer's overvaluation "becomes irrelevant to the determination of any tax due." *Gainer*, 893 F.2d at 228. The Federal Circuit has aptly explained the flaw in that reasoning:

> The Blue Book ... offers the unremarkable proposition that, when the IRS disallows two different deductions, but only one disallowance is based on a valuation misstatement, the valuation misstatement penalty should apply only to the deduction taken on the valuation misstatement, not the other deduction, which is unrelated to valuation misstatement. The court in *Todd* mistakenly applied that simple rule to a situation in which the *same* deduction is disallowed based on both valuation misstatement- and non-valuation-misstatement theories.
>
> *Alpha I, L.P.*, 682 F.3d at 1029.
>
> We note also that more recent Fifth and Ninth Circuit decisions retreat from *Todd* and *Gainer*. In *PBBM-Rose Hill, Ltd. v. Commissioner,* for instance, the Tax Court had denied PBBM's charitable contribution deduction for failing to meet the statutory requirements for "a qualified conservation easement." 900 F.3d 193, 209 (5th Cir. 2018). The Fifth Circuit nonetheless affirmed the Tax Court's imposition of a penalty for a gross valuation misstatement for having also misstated the value of the easement. *Id.* at 215; *see also Keller v. Comm'r*, 556 F.3d 1056, 1060-61 (9th Cir. 2009) (recognizing the approach we take here as "sensible," but explaining that its decision is "constrained by *Gainer*").
>
> In sum, because the Tax Court determined that RERI made a gross valuation misstatement and that misstatement was an independent alternative ground for adjusting RERI's deduction, the penalty properly applies.

The Court upheld the Tax Court's determination of value.

7. Judicial Extinguishment. Woodland Property Holdings v. Commissioner, T.C. Memo. 2020-55, denied a charitable deduction for a conservation easement because the easement could be extinguished by judicial action. The opinion states:

> For an easement of the sort involved here, a charitable contribution deduction is allowable only if the underlying conservation purpose is "protected in perpetuity." Sec. 170(h)(5)(A); see Coal Prop. Holdings, 153 T.C. at 135. The regulations set forth detailed rules for determining whether this "protected in perpetuity" requirement is met. See sec. 1.170A-14(g), Income Tax Regs.
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> The rules governing "judicial extinguishment" appear in section 1.170A-14(g)(6), Income Tax Regs. It provides that the donor must agree that the easement gives rise to a property right in the donee having a FMV "that is at least equal to the proportionate value that the * * * [easement] at the time of the gift, bears to the value of the property as whole at that time." Id. subdiv. (ii) (emphasis added). In the event of a sale following judicial extinguishment of the easement, the donee "must be entitled to a portion of the proceeds at least equal to that proportionate value." Ibid. "In effect, the 'perpetuity' requirement is deemed satisfied because the sale proceeds replace the easement as an asset deployed by the donee 'exclusively for conservation purposes.' " Coal Prop. Holdings, 153 T.C. at 136(quoting section 170(h)(5)(A)).
>
> The regulation requires, in short, that the donee receive a proportionate share of the sale proceeds, as determined by the fraction set forth in the regulation.[3] The easement deed in this case does not satisfy this requirement. The deed defines the donee's share of the sale proceeds as the FMV of the easement, determined "as of the date of this Conservation Easement." The donee's share is thus restricted to

> "a date-of-gift value that would exclude subsequent appreciation." R.R. Holdings, at *13. The donee would accordingly "watch its proportion of potential extinguishment proceeds shrink over the years if the underlying property appreciates." Ibid. This shrinking value does not equal the "proportionate value" of the sale proceeds that the regulation mandates that the donee receive.

The court notes other similar cases:

> As petitioner acknowledges, the question presented by respondent's motion is identical, "with similar conservation easement language," to the question decided adversely to the taxpayer in R.R. Holdings, LLC v. Commissioner, T.C. Memo. 2020-22, and Oakbrook Land Holdings, LLC v. Commissioner, T.C. Memo. 2020-54. This question is substantially similar to that decided adversely to the taxpayer in PBBM-Rose Hill, Ltd. v. Commissioner, 900 F.3d 193 (5th Cir. 2018), and Coal Prop. Holdings, LLC v. Commissioner, 153 T.C. 126 (2019).

See also Railroad Holdings v. Commissioner, T.C. Memo. 2020-22; and Rock Creek Property Holdings v. Commissioner, Tax Court Order, Docket No. 5599-17 (February 10, 2020).

In a separate, reviewed, opinion to the one cited above, Oakbrook Land Holdings v. Commissioner, 154 T.C. No. 10 (2020), the Tax Court upheld the "protected in perpetuity" regulation. In 1983 the IRS issued a proposed regulation with a "perpetuity" requirement, and received more than 700 pages of comments. With respect to the procedural aspects of the regulation, the opinion states:

> The two aspects of the "judicial extinguishment" rule to which petitioner objects are the requirement that the donee receive a proportional share of the proceeds and the fact that the "proportionate share" formula does not account for the possibility of donor improvements. Treasury clearly considered the comments it received on the first point because it substantially revised the text of section 1.170A-14(g)(6)(ii), Income Tax Regs., in response to those comments. See supra pp. 14-15.
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> Only one of the 90 commenters mentioned donor improvements, and it devoted exactly one paragraph to this subject. That commenter, NYLC, was concerned about facade easements on historic structures, as opposed to "perpetual open space easements," with which Treasury was chiefly concerned. See 48 Fed. Reg. at 22940. And NYLC mentioned this point to support its belief that donors of facade easements "are likely to be discouraged from making a donation," a supposition that Treasury may reasonably have discounted.
>
> In any event, "[t]he administrative record reflects that no substantive alternatives to the final rules were presented for Treasury's consideration." SIH Partners, 150 T.C. at 44; see dissenting op. p. 102 ("A comment is * * * more likely to be significant if the commenter suggests a remedy for the purported problem it identifies."). NYLC offered no suggestion about how the subject of donor improvements might be handled; it simply recommended "deletion of the entire extinguishment provision." Only one other commenter of the 13 mentioning judicial extinguishment voiced that recommendation.

Footnote 3, relevant to the dissent, states:

> Our dissenting colleague errs in relying on United States v. Nova Scotia Food Prods. Corp., 568 F.2d 240 (2d Cir. 1977), to support his position. See dissenting op. pp. 110-113. That case involved a Food and Drug Administration (FDA) regulation establishing minimum "time, temperature, and salinity" requirements for processing fish. The Second Circuit invalidated the regulation as applied to one category of fish product, "non-vacuum-packed hot-smoked white-fish." Nova Scotia Food Prods. Corp., 568 F.2d at 253. The court first held that the FDA had "failed to disclose to interested parties the scientific data and the methodology upon which it relied." Id. at 250. "When the basis for a proposed rule is a scientific decision, the scientific material which is believed to support the rule should be exposed to the view of interested parties for their comment." Id. at 252. The court also held that the agency had failed to consider: (1) evidence that heating "certain types of fish to high temperatures will completely destroy the product," (2) the suggestion that using "nitrite and salt as additives could safely lower the high temperature otherwise required," and (3) the suggestion that different processing requirements should be established for different species of fish. Id. at 245. Here, the basis for the proposed regulation was not "a scientific decision"; Treasury relied on no undisclosed data when proposing its regulation; the two commenters who opposed the judicial extinguishment rule offered no concrete alternative suggestions; and the concerns they expressed lacked the significance of concerns about destroying the commercial viability of a product, which the Second Circuit aptly described as "vital questions" in Nova Scotia Food Prods. Corp., 568 F.2d at 252.
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> The broad statements of purpose contained in the preambles to the final and proposed regulations, coupled with obvious inferences drawn from the regulations themselves, are more than adequate to enable us to perform judicial review. We find that Treasury's rationale for the judicial extinguishment rule "can reasonably be discerned and * * * coincides with the agency's authority and obligations under the relevant statute." SIH Partners, 150 T.C. at 47. We accordingly hold that Treasury satisfied all applicable APA requirements when promulgating this rule.

The court then turned to the substance, analyzed under Chevron as explained by the court:

> Having concluded that the regulation was properly promulgated, we turn to petitioner's contention that the regulation is substantively invalid. When considering a challenge to the substantive validity of a regulation, we generally employ the two-part test established by Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc., 467 U.S. 837 (1984). The first prong of that test asks "whether Congress has directly spoken to the precise question at issue." Id. at 842. "If the intent of Congress is clear, that is the end of the matter." Ibid.
>
> Section 170(h)(5)(A) sets forth a general requirement that the conservation purpose be "protected in perpetuity." Congress does not appear to have considered the possibility that an easement might be judicially extinguished, and the statute does not address how that possibility would affect a taxpayer's ability to satisfy the "perpetuity" requirement. Congress therefore did not speak directly to the question at issue.
>
> We accordingly proceed to Chevron step two, which requires us to consider whether the regulation "is based on a permissible construction of the statute." Chevron, 467 U.S. at 843. If the statute is silent, we must give deference to the interpretation embodied in the agency's regulation unless it is "arbitrary,

> capricious, or manifestly contrary to the statute." Id. at 844; see United States v. MeadCorp., 533 U.S. 218, 227 (2001). In other words we must sustain the regulation so long as it represents a "reasonable interpretation" of the law Congress enacted. Chevron, 467 U.S. at 844; see SIH Partners, 150 T.C. at 50.

The court determined that the regulation was valid under Chevron:

> We cannot say that the regulation's "proportionate value" approach is "arbitrary, capricious, or manifestly contrary to the statute." Chevron, 467 U.S. at 844. Under the regulation the donee acquires "a property right, immediately vested in the donee organization," in a share of any future proceeds. Sec. 1.170A-14(g)(6)(ii), Income Tax Regs. Needless to say, the easement might be extinguished many years after it was granted, and considerable inflation in property values might occur in the interim. If the donee's share were limited to the easement's historical FMV, its property right could be eviscerated in real dollar terms. This would allow the donor or its successors to "reap[ ] a windfall if the property is destroyed or condemned." Carroll, 146 T.C. at 214 (quoting Kaufman, 687 F.3d at 26). That outcome would be at odds with the regulation's central purpose: to ensure satisfaction of the statute's "protected in perpetuity" requirement by supplying the donee with an asset that replaces, in real terms, the easement that has been lost.
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> Second, petitioner contends that the regulation is invalid because it does not permit the donee's share of the proceeds to be reduced by the value of improvements (if any) made by the donor. The regulation as proposed did not address donor improvements, and only one of 90 commenters mentioned the point. See supra pp. 21-22. Once again, we cannot say that the absence of a provision addressing donor improvements renders the regulation "arbitrary, capricious, or manifestly contrary to the statute." Chevron, 467 U.S. at 844.
>
> Treasury's goal in prescribing this regulation was to ensure satisfaction of the statute's "protected in perpetuity" requirement. In effect this requirement is deemed satisfied because the sale proceeds replace the easement as an asset deployed by the donee "exclusively for conservation purposes." Sec. 170(h)(5)(A). In certain factual scenarios, reducing the donee's proceeds on account of donor improvements could frustrate this goal, especially if local land values should decline.
>
> For example, assume that a taxpayer donates an easement valued at $1 million on property valued at $2 million without the easement. The taxpayer thereafter spends $1 million improving the property. Many years later, there is an economic downturn, the easement is extinguished, and the property is sold for $2 million. Under the regulation the donee would be entitled to $1 million (half of the proceeds) and the conservation purpose would be deemed "protected in perpetuity." Sec. 170(h)(5)(A). But if improvements were carved out, the donee's share would be reduced to $500,000 or zero, depending on whether the carve-out was applied to the entire proceeds or to the donee's 50% share.
>
> NYLC, the only commenter to mention donor improvements, notably did not suggest any text to address this problem. And addressing it would have raised a host of questions: Would the donee's proceeds be reduced by improvements the donor had made before granting the easement, after granting it, or both? Would the donor get credit for improvements to the land itself (such as grading) or only for erecting structures? Would the donee's proceeds be reduced by the donor's

> cost for the improvements or by their FMV at the time the easement was extinguished? And how would the problem mentioned in the previous paragraph be solved, to prevent the donee's share from being severely reduced or even eliminated? It is conceivable that Treasury could have drafted a regulation that addressed the possibility of donor improvements, dealing with these ancillary questions in some rational way. But that was a policy decision for Treasury, not this Court, to make.

The court thought it significant that the regulation was finalized long ago in 1986:

> The regulation petitioner challenges was promulgated in January 1986. It has never been amended. In the past 34 years Congress has amended section 170 more than 30 times, but these amendments have never suggested any disagreement with the construction of the statute that Treasury adopted in section 1.170A-14(g)(6), Income Tax Regs. This "strongly suggests that * * * [Congress] did not view Treasury's construction * * * as unreasonable or contrary to the law's purpose." <u>SIH Partners</u>, 150 T.C. at 53-54 (sustaining under <u>Chevron</u> step two a regulation that had persisted substantially unchanged for nearly 50 years).
>
> [footnote omitted]

Twelve judges signed on to the majority opinion. There was a concurrence and a dissent. The concurrence in result only by Judge Toro would have flunked the regulation under <u>Chevron</u> but disallowed the deduction because the charity did not receive all the state law property rights in the land. That opinion states:

> Oakbrook maintains that the requirement of section 170(h)(5)(A) is met so long as the donee, upon a sale or other disposition after extinguishment by judicial proceeding, would obtain an amount equal to the fair market value of the easement at the time the easement was established, subject to reduction for subsequent improvements funded exclusively by the donor.[3] But Oakbrook's position ignores the fact that, to be eligible for a deduction under section 170(h) in the first place, a donor must grant to a donee an "interest[ ] in real property." Sec. 170(h)(2). One of the rights inherent in a real property interest (and presumably required to be transferred to the donee in order to satisfy section 170(h)(2)(C)) is the property holder's right to be compensated at fair market value upon a subsequent transfer or taking.
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> The formula set out in the Deed exposes the fundamental problem for Oakbrook-under the terms of the Deed, the donee never received the type of "interest[ ] in real property" contemplated by section 170(h)(2)(C) and further protected by section 170(h)(5)(A). Put another way, by failing to convey to the donee the unrestricted right to be compensated at fair market value upon a future transfer or taking, the Deed so restricted the donee's interest as to cause it to fall outside the purview of section 170(h)(2)(C).
>
> The shortcoming inherent in the Deed also affects Oakbrook's compliance with section 170(h)(5)(A). The payment of a predetermined fixed amount would be insufficient as compensation for a right "protected in perpetuity" if the fair market value of the property had appreciated since the date the easement was granted. When a transfer of money to the donee is intended to satisfy the "perpetuity of purpose" requirement of section 170(h)(5)(A), no reasonable reading of the statute would bless the donee receiving an amount that is less than the fair market value

> of its "interest[ ] in real property" as of the time of the conversion of its interest into cash.

On the other hand, Judge Toro would have invalidated the donor improvement portion of the regulation:

> I begin at the same starting place--the statutory text. The statute provides a deduction for a contribution to a qualified organization of a "qualified real property interest" made "exclusively for conservation purposes." Although the statute makes clear that there can be no deduction unless the conservation purposes are "protected in perpetuity," one cannot lose track of the fact that the deduction is predicated on a "qualified real property interest" being contributed to a qualified organization. Thus, the most that a qualified organization can be entitled to receive if its "qualified real property interest" is extinguished in the future is the full value of that interest. Whatever the purpose of a contribution, that purpose may not be invoked to require the donor to give the donee, as a precondition to receiving a deduction for his contribution, a right to receive compensation properly attributed to the real property interest that the Code permits the donor to retain. A regulation interpreted to require otherwise cannot be a permissible interpretation of the statutory text before us. Under that text, the interest the donee organization must obtain in connection with a contribution is the "qualified real property interest" transferred to it. Requiring the donor to promise to turn over to the donee proceeds in excess of the fair market value of that interest is inconsistent with the statutory framework, and nothing in the "statutory purposes" compels a different conclusion. Goldstein, 451 F.3d at 881 (quoting Abbott Labs., 920 F.2d at 988).
>
> The opinion of the Court admits that "[i]t is conceivable that Treasury could have drafted a regulation that addressed the possibility of donor improvements, dealing with [the types of questions noted above] in some rational way." See op. Ct. p. 30. But the opinion of the Court overlooks the lack of a "rational" solution to those problems, by noting that "that was a policy decision for Treasury, not this Court, to make." See id. In the Court's view, "Treasury's overarching goal [in prescribing the regulation] was to guarantee that the donee, upon judicial extinguishment of the easement, would receive the full share of proceeds to which it was entitled. * * * Treasury exercised reasoned judgment by adhering to a simple rule that splits sale proceeds in a direct proportional manner." See id. p. 31.
>
> I agree with the opinion of the Court that the donee should "receive the full share of proceeds to which it was entitled." See id.(emphasis added). But a rule interpreted to require the deed to allocate to the donee not only the proceeds attributable to its own real property interest but also a share of the proceeds attributable to the interest the Code permits the donor to retain does not " ' "fit" ' with the statutory language" and is unreasonable. Good Fortune Shipping SA v. Commissioner, 897 F.3d at 262 (quoting Goldstein, 451 F.3d at 881). Calling it a "policy decision" does not change the fact that the rule, as interpreted by the Commissioner, yields in certain circumstances a result that is entirely unreasonable and without any basis in the statute. Under Chevron, Treasury is entitled to draw lines on the page provided by Congress; Chevron does not give Treasury legislative authority to substitute a different page for the one Congress enacted into law.

Judge Toro also found the procedural part of the rulemaking defective:

In response to the notice, Treasury received more than 700 pages of comments during the extended comment period and at least another 130 pages after the comment period had closed. A hearing on the proposed regulation was requested and was held on September 15, 1983. Thirty-seven members of the public were originally scheduled to speak at the hearing, and 30 actually spoke. The hearing lasted more than five hours, and the transcript exceeds 200 pages.

A Treasury Decision adopting final regulations was published in the Federal Register on January 14, 1986. See T.D. 8069, 1986-1 C.B. 89, 51 Fed. Reg. 1496 (Jan. 14, 1986). The Treasury Decision spanned roughly 12 pages, of which approximately 10 contained the actual text of the regulations. That left just over two pages for Treasury's responses to comments and other administrative matters (for example, the Paperwork Reduction Act notice and drafting information). Put another way, Treasury used six columns of the Federal Register to address more than 700 pages of timely comments and more than 200 pages of public testimony. Those six columns were intended to cover comments on a "regulation project consisting of 10 paragraphs, 23 subparagraphs, 30 subdivisions, and 21 examples." See op. Ct. p. 24.

One might wonder how an agency familiar with the D.C. Circuit's decision in Home Box Office, which by 1986 had been on the books for more than eight years, could have thought that six columns in the Federal Register sufficed to "respond[ ] to significant points raised by the public" in more than 700 pages, or how that response constituted a "dialogue" between the agency and the public contemplated by the APA as interpreted by Home Box Office and the authorities on which it relied. Home Box Office, 567 F.2d at 35-36 (fn. ref. omitted); see also PPG Indus., 630 F.2d at 466 (reiterating that the APA requires agencies "to give reasoned responses to all significant comments in a rulemaking proceeding"). Even for an agency determined to be exceedingly "concise," six columns in the Federal Register would be a tight amount of space to show "what major issues of policy were ventilated ... and why the agency reacted to them as it did." Carlson, 938 F.3d at 344 (alteration in original) (quoting Del. Dep't of Nat. Res. & Envtl. Control v. EPA, 785 F.3d 1, 17 (D.C. Cir. 2015)).

But, in my view, Treasury did not think it confronted such a Herculean task. It is more likely that Treasury was simply following its historical position that the APA's procedural requirements did not apply to these types of regulations.[15] As the Treasury Decision explains, Treasury took the view that "[a]lthough a notice of proposed rulemaking which solicited public comments was issued, the * * * [IRS] concluded when the notice was issued that the regulations are interpretative and that the notice and public comment procedure requirement of 5 U.S.C. 553 did not apply." T.D. 8069, 1986-1 C.B. at 92. When an agency engaged in a particular rulemaking exercise believes the APA does not require it to provide notice and receive comments at all, it is not difficult to see why that agency might think that a rather brief explanation, offered as it were out of its own generosity, should be good enough.[17]

The problem with this position, however, is that Treasury's conclusion that the regulation at issue here did not require notice and comment was mistaken, as the opinion of the Court correctly makes clear

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The NYLC Comment Letter in effect countered that the proposed rule on future donor improvements was contrary to those policy decisions, would lead to inequitable results that were inconsistent with the statute, and would deter future

> contributions. In short, the NYLC Comment Letter offered comments that, "if adopted, would require a change in an agency's proposed rule." Home Box Office, 567 F.2d at 35 n.58. Those comments were both "relevant and significant," requiring a response. Grand Canyon, 154 F.3d at 468; accord Carlson, 938 F.3d at 343-344.
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> Unfortunately, however, the Treasury Decision finalizing the regulations contains no such response. The Treasury Decision changed the sentence on which the Commissioner relies with respect to donor improvements as follows (with the relevant change underscored):
>
>> (1) Proposed Regulation: "For purposes of this paragraph (g)(5)(ii), that original minimum proportionate value of the donee's property rights shall remain constant." 48 Fed. Reg. 22946.
>>
>> (2) Final Regulation: "For purposes of this paragraph (g)(6)(ii), that proportionate value of the donee's property rights shall remain constant." T.D. 8069, 1986-1 C.B. at 99.
>
> But Treasury gave no explanation as to how the change addressed the concerns expressed in the NYLC Comment Letter. In short, Treasury's actions did not provide "an explanation [that] is clear enough that its 'path may reasonably be discerned.' " Encino Motorcars, 579 U.S. at ___, 136 S. Ct. at 2125 (quoting Bowman Transp., 419 U.S. at 286).[18] Nor does Treasury's action provide any insight on "what major issues of policy were ventilated ... and why the agency reacted to them as it did" on this point. Carlson, 938 F.3d at 344 (quoting Del. Dep't of Nat. Res. & Envtl. Control, 785 F.3d at 17).

Three judges agreed with portions of Judge Toro's opinion.

The dissent reviewed multiple comments to Treasury's proposed regulation and then turned to Treasury's response:

> What we hear is the chirping of crickets.
>
> The Final Rule's statement of basis and purpose shows absolutely no mention of the extinguishment-proceeds clause at all, much less any mention of the proportionate-share or improvements problems--and no reasoned response to any of the public's comments on those provisions.[9] The majority doesn't deny this, see op. Ct. pp. 23-25, and we aren't even the first court to notice: In Kaufman v. Shulman, 687 F.3d 21, 26 (1st Cir. 2012), the First Circuit was forced to guess at the apparent purpose of the section 1.170A-14(g)(6)(ii), Income Tax Regs., after noting that it "was unexplained when first promulgated."
>
> This makes the defining characteristic of section 1.170A-14(g)(6)(ii), Income Tax Regs., its utter lack of any contemporaneous explanation of its key choices--to require that donees get a fraction, rather than an absolute amount, of extinguishment proceeds and to require that they get a share of any proceeds from a donor's improvements to the property. There is no prefiguring of these choices in the legislative history or the notice of proposed rulemaking, and no explanation of them in the Final Rule. Had Treasury responded in any meaningful way to the comments that it received, such as those from the NYLC, neither donors and donees, nor courts, see, e.g., Oakbrook, T.C. Memo. 2020-54, at *20-*28 (highlighting the confusing nature of section 1.170A-14(g)(6), Income Tax Regs.,

> and attempting to discern its meaning), nor the IRS, compare Priv. Ltr. Rul. 200836014 (Sept. 5, 2008) (stating that the regulation isn't violated by a conservation easement in which a donee receives only proceeds less any amount attributable to an improvement), with Oakbrook, T.C. Memo. 2020-54, at *36 (addressing the IRS's argument that a conservation easement in which a donee receives only proceeds less any amount attributable to an improvement is a violation of the regulation), would have to grapple with whether "proportionate value" establishes a fraction or a fixed value, or whether a donee is entitled to any extinguishment proceeds attributable to the value of improvements or rising land values. Such widespread industry confusion is precisely what APA section 553 is intended to avoid. So while we don't demand a perfect explanation for Treasury's decision making, see Bowman Transp., 419 U.S. at 286, we should demand some, see Encino Motorcars, 579 U.S. at __, 136 S. Ct. at 2125. And here, there wasn't any.

With respect to the substance, the dissent notes that Chevron can be applied in different ways – which is right is uncertain at the moment – and that Treasury now justifies the regulation on grounds different from what it did when it issued the regulation. As to this point, the dissent states:

> These seem like perfectly plausible reasons. But they are not the ones that Treasury itself offered at the time it issued the regulation. This raises another problem for the Commissioner in his defense--the Chenery rule. The Chenery rule prevents an agency from relying on *post hoc* rationalizations to defend its decision making. SEC v. Chenery Corp., 318 U.S. 80, 87 (1943) ("The grounds upon which an administrative order must be judged are those upon which the record discloses that its action was based."); see also State Farm, 463 U.S. at 50 (courts may not accept post hoc rationalizations). And Chevron step 2 is limited by Chenery. Bank of Am., N.A. v. FDIC, 244 F.3d 1309, 1319 (11th Cir. 2001) (stating that Chenery must be considered at step 2 of Chevron); see also Council for Urological Interests v. Burwell, 790 F.3d 212, 222 (D.C. Cir. 2015); America's Cmty. Bankers v. FDIC, 200 F.3d 822, 835 (D.C. Cir. 2000). We shouldn't be coming up with our own *post hoc* justifications for the reasonableness of the rule if the Commissioner's lawyers wouldn't be able to.
>
> The same problem affects our analysis of the substantive validity of this regulation under State Farm. The Sixth Circuit has warned agencies that its arguments in favor of a regulation not being "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law" is likewise limited by the Chenery rule. See Atrium, 766 F.3d at 567-68 ("[T]he ground upon which an administrative order must be judged are those upon which the record discloses that its action was based." (quoting Chenery, 318 U.S. at 87)).
>
> The majority today comes up with as good a set of arguments as possible to justify the reasonableness of the regulatory choices that Treasury made when it was drafting this regulation. But Treasury didn't make them. Or at least it didn't make them in the administrative record of this regulation.

8. Golf Course Does Not Automatically Invalidate Conservation Easement Deduction. The Eleventh Circuit in Champions Retreat Golf Founders v. Commissioner, 2020 WL 2462534 (11th Cir. 2020) summarized the case as follows:

> The appellant taxpayer claimed a charitable deduction for donating a conservation easement over property that included a private golf course and undeveloped land.

> The Commissioner of Internal Revenue disallowed the deduction, and the Tax Court upheld the decision. The deduction was proper if the donation was made for "the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem," or was made for "the preservation of open space . . . for the scenic enjoyment of the general public." I.R.C. § 170(h)(4)(A)(ii) & (iii)(I).
>
> Without the golf course, this easement would easily meet these criteria. Because the Code does not disqualify an easement just because it includes a golf course, we reverse the Tax Court's decision and remand for determination of the proper amount of the deduction.

One of the issues addressed by the court was whether the land was required to be natural, or was the habitat required to be natural. The opinion states:

> The Commissioner's expert takes no issue with the proposition that many birds use the property including some that are worthy of protection. He says, though, that the habitat itself is not relatively natural. For this he focuses on the fairways and greens — they consist of non-native bermuda and bent grass — not the undeveloped portion of the easement, which is, at least for the most part, quite natural.
>
> What matters under the Code and regulation is not so much whether all the *land* is natural, but whether the *habitat* is natural. Indeed, the regulation says it is not disqualifying that the land has been altered, so long as "the fish, wildlife, or plants continue to exist there in a relatively natural state." 26 C.F.R. § 1.170A-14(d)(3)(i). The Commissioner's expert noted nothing unnatural about these birds' existence; they apparently find the habitat quite suitable.
>
> Champions also cites the property's population of southern fox squirrels — a species for which the habitat, including the golf course, is hospitable. The species is not threatened but has suffered declines caused by diminishing habitat, due in part to forest-management practices. The Commissioner discounts the importance of the species, noting that Georgia has a six-month season in which hunters may take up to 12 squirrels per day. But that is not dispositive of the question whether providing the squirrels a habitat is a conservation purpose. That Georgia chooses not to protect the species hardly seems a reason to deny whatever protection is available under *federal* law. Protecting fox squirrels would not alone be sufficient to establish a conservation purpose, but they add to the weight on Champions' side of the scale.
>
> Finally, while the golf course itself is comprised primarily of non-native grasses, the remainder of the easement property is natural and includes a rare species of plant, the denseflower knotweed. The Commissioner has offered no theory under which protecting the denseflower knotweed is not an appropriate conservation purpose.
>
> It is true, as the Commissioner notes, that the knotweed exists on only a limited proportion of the easement — perhaps 7%, with the capacity to occupy up to 17%. But the knotweed that exists, whatever its proportion, is worthy of protection.

A discussion of the Tax Court's approach to birds cannot be read without a smile:

> Despite the abundant bird species, including many of conservation concern, the declining southern fox squirrels, and the rare denseflower knotweed, the Tax

Court said Champions had not established the required conservation purpose. To reach this result, the court considered, or at least discussed in its opinion, only birds seen by both Champions experts — ignoring any bird seen by only one Champions expert, even if the bird was also seen by the Commissioner's expert. The court did this despite explicitly crediting the testimony of both Champions experts. The court offered no explanation for this approach, and we can conceive of none.

The court also ignored a bird that was heard but not seen. The court did not explain how a bird could be heard if not present on or at least near the property.

The Tax Court's implicit finding that the only birds on the property were those seen by both Champions experts is clearly erroneous. More importantly, the Tax Court's conclusion that Champions did not contribute this easement “for the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem” — a conclusion based in part on the clearly erroneous finding of fact — is wrong as a matter of law.

Were it not for the presence of a golf course on part of this property, the assertion that contributing an easement over property with this array of species does not qualify as a conservation purpose would be a nonstarter.

The concerned land is also scenic, notes the court:

> The record establishes without dispute that members of the public can and do canoe and kayak on the Savannah River alongside the easement and on the Little River as it runs through the easement. The view from the rivers includes the easement's natural areas as well as the golf course. The record includes a video illustrating the stark difference in the views of the easement property, on the one hand, and the property farther down the Savannah River, on the other. The downriver property includes considerable development — development that few canoers or kayakers would find scenic.
>
> One could perhaps debate whether a golf course provides scenic enjoyment. But the natural areas covered by this easement surely do. And the golf course, whose most prominent feature visible from a canoe or kayak on the river is the trees, detracts only a little, if at all. When compared to a condominium building or even private homes, the easement property qualifies as open space providing scenic enjoyment. And preserving relatively natural views along these two rivers — views free of development on the other side as well because of the national forest — serves a public interest.
>
> In asserting the contrary, the Commissioner says the rivers' banks are from three to ten feet high, as if this somehow eliminates the opportunity for scenic enjoyment. The Tax Court took the same approach. But trees, on the one hand, and condos or other buildings, on the other hand, can be seen from a canoe or kayak, even when a river's banks are ten feet high. Indeed, if a ten-foot bank obscures anything, it is the fairways and greens and other non-natural features of a golf course, not the trees. From a kayak on a river with a ten-foot bank, the flat parts of a golf course look just like open land. The notion that the banks somehow prevent scenic enjoyment is a makeweight.
>
> Were it not for the presence of a golf course on part of this property, the assertion that preserving open space alongside rivers with three- to ten-foot banks cannot be "for the scenic enjoyment of the general public" and provide a public benefit would be a nonstarter.

A dissent thought that the property was scenic but was dubious about the other conservation values:

> *Second*, in my view, Champions' easement might not be a "relatively natural habitat." I.R.C. § 170(h)(4)(A)(ii). The man-made golf course takes up more than 80 percent of the easement. In making the course, Champions used non-native grasses, one of which requires the use of large fans to keep it cool in the hot Georgia sun. And to maintain the course, Champions pumps anywhere from 70,000 to 600,000 gallons of water a day out of the Little River.
>
> Champions also coats its golf course with chemicals — including fungicide, herbicide, insecticide, algaecide, and fertilizer. To apply these potent chemicals, Champions' staff members sometimes need gloves and respirators. The chemicals not only artificially change the habitat, but do so in ways that pose what the tax court called "environmental hazards." In fact, Champions designed the golf course to drain into nearby ponds, creeks, and otherwise undisturbed wetlands. The golf course drains toward the knotweed (a rare plant that Champions says is protected by the easement), and as the majority itself recognizes, "the knotweed thus may suffer harm from the chemicals used on the course." Maj. Op. at 14. Although the majority finds comfort in Champions' pledge to follow the golf industry's best environmental practices, we have little information about what

> those practices are, or how they stack up to other standards. And those standards, whatever they are, hardly define the boundary between easements that can and cannot qualify for a deduction under federal law.
>
> Ultimately, the majority is willing to look past the easement's unnatural features because of the birds and squirrels living there. The argument has some force, especially because it does appear that the tax court overlooked evidence about the prevalence of these species. But the presence of animals cannot hide that a lot of the easement is highly developed and at least somewhat hazardous to certain species. And no matter how many animals live on the Champions easement, the reality remains the same: with the chemicals, imported grasses, large fans, artificial drainage, and water pumping, it is not at all clear that the easement amounts to a "relatively natural habitat." I do not mean to say that a golf course could never qualify; it's simply not clear that this one does.

9. **<u>Perpetuity Requirement in Façade Easement</u>**. The Sixth Circuit has strictly construed the perpetuity requirement for conservation easements in <u>Hoffman Properties v. Commissioner</u>, 956 F.3d 832 **(**6th Cir. 2020). The opinion states:

> The parties agree on the general legal framework. To satisfy the "perpetuity" requirement, the donation must be "[e]nforceable in perpetuity," meaning that it includes "legally enforceable restrictions" that will prevent the donor from using its retained interest in the property in a way "inconsistent with the [donation's] conservation purposes." Treas. Reg. § 1.170A-14(g)(1); *see Glass v. Comm'r*, 471 F.3d 698, 713 (6th Cir. 2006). The parties simply disagree about whether Hoffman's donation included adequate restrictions.
>
> ***
>
> The key language in this agreement is in Paragraph 3. That Paragraph describes certain "[c]onditional [r]ights"—actions that Hoffman could take so long as AAHP approved. JA 107. For instance, Hoffman reserved the right to "[a]lter, reconstruct or change the appearance [of the façade] . . . contrary to the Secretary's Standards" or to "[a]lter or change the appearance of the Air Space in a manner contrary to the Secretary's Standards." JA 107–08. (For reference, the "Secretary's Standards" are regulations issued by the Secretary of the Interior on the rehabilitation of historic buildings. 36 C.F.R. § 67.7.) Paragraph 3 also directs Hoffman to submit these proposed changes to AAHP, which would review the changes based on the Secretary's Standards and either approve or reject them. Finally, the Paragraph makes clear that AAHP's "failure . . . to act within forty-five (45) days of receipt [of a proposed change] shall be deemed to constitute approval [of the change] and to permit [Hoffman] to undertake the proposed activity." JA 108.
>
> Simply put, Paragraph 3 gives AAHP a 45-day window in which to prevent certain changes to the façade or airspace. And if the organization misses that window—for whatever reason—it loses the ability to stop the change. It almost goes without saying that this provision violates the "perpetuity" requirement. After all, there's a world of difference between restrictions that are enforceable "in perpetuity" and those that are enforceable for only 45 days. *See The American Heritage Dictionary* 977 (1976) (defining "perpetuity" as "[t]ime without end; eternity"); *Black's Law Dictionary* 711 (5th ed. 1979) (defining "in perpetuity" as "[e]ndless duration; forever"); *Webster's Third New International Dictionary*

> 1685 (1986) (defining "perpetuity" as "endless time" and a "duration without limitations as to time"). You can't even really compare the two.
>
> What's more, it seems that most (if not all) of the rights reserved in Paragraph 3 could be inconsistent with the conservation purposes of the donation. We know this not only because of the sheer breadth of the reserved rights—for instance, the power to "[a]lter, reconstruct, or change" the façade—but also because many of the rights are expressly defined as "contrary to the Secretary's Standards." JA 107. Recall that these standards concern the rehabilitation of historic buildings; they're designed to ensure that any changes are "consistent with the historic character of the property." 36 C.F.R. § 67.7(e). And the donation agreement itself tells AAHP to use these standards when it evaluates whether a proposed change would conflict with the purposes of the donation. So it's not hard to imagine how these changes would be inconsistent with the conservation purposes of the donation. By all appearances, then, the agreement fails to protect these purposes "in perpetuity."
>
> ***
>
> *The Donation Agreement*. Hoffman also insists that other provisions in the agreement protect the conservation purposes "in perpetuity." But this argument misses the point: whatever else the agreement says, Paragraph 3 prevents AAHP from enforcing these provisions if the organization fails to act on the proposed change within 45 days. And again, this brief window falls far short of the statutory requirement that the conservation purposes of the donation be "protected in perpetuity." I.R.C. § 170(h)(5)(A).
>
> For similar reasons, Paragraph 10 doesn't do Hoffman any good even though it provides that the agreement "shall be interpreted broadly to effect its purposes and the transfer of rights and the restrictions on use." JA 118. This provision tells us to construe the agreement, not rewrite it. *Cf. Keen v. Helson*, 930 F.3d 799, 805 (6th Cir. 2019). But there's no way Hoffman could prevail unless we rewrote some of the terms in Paragraph 3.1.

Footnote 1 addresses savings clauses:

> Curiously, Hoffman doesn't point to the one provision in the agreement that might support this result. Paragraph 10 includes what appears to be a saving clause: "Notwithstanding anything to the contrary herein, [the parties] agree that [AAHP] shall hold this [donation] 'exclusively for conservation purposes' as that term is defined in the Code and [its] implementing regulations[.]" JA 118. Hoffman might have argued that this clause negates any other provision in the agreement that would render the donation not "exclusively for conservation purposes"—such as the 45-day provision. But perhaps it didn't make this argument because other courts have found saving clauses unenforceable in this context. *See, e.g., Belk v. Comm'r*, 774 F.3d 221, 228–30 (4th Cir. 2014); *R.R. Holdings, LLC v. Comm'r*, 119 T.C.M. (CCH) 1136, 2020 WL 569926, at *6–7 (2020). Since Hoffman hasn't raised the issue, we'll leave it for another day.

The taxpayer argued that it had amended the original agreement to correct the problem but that amendment had not been recorded, as the original required, and the taxpayer presented no evidence that the chances the 45-day clause would be implicated were so remote as to be negligible.

Suppose the 45-day clause were the reverse: if no response from the charitable organization then no change could be made. Chief Counsel Memorandum 202002011 approved such a clause stating:

> **Constructive Denial.** For activities or uses that are expressly permitted by the terms of the easement only with the easement holder's approval, the property owner's request for approval shall be in writing and shall describe the nature, scope, design, location, timetable, and any other material aspect of the proposed activity or use in sufficient detail to permit the easement holder to make an informed determination regarding approval or denial of the request. Such a request shall be delivered to the easement holder at least sixty (60) days prior to the anticipated start date of such activity or use.
>
> The easement holder agrees to use reasonable diligence to respond to such a request within the sixty (60) days of delivery. The easement holder's failure to respond to such a request within the sixty (60) day period shall be deemed a constructive denial.
>
> Because a constructive denial is not a decision by the easement holder based on the merits of the property owner's request, it is not final or binding on the easement holder, and the property owner can resubmit the same or a similar request for approval.
>
> Section 170(h)(1) allows a deduction for a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes. Section 170(h)(2)(C) states that a qualified real property interest is a restriction (granted in perpetuity) on the use of the real property. Section 170(h)(5)(A) further provides that in order for a contribution to be treated as exclusively for conservation purposes, the conservation purpose must be protected in perpetuity.
>
> <u>CONCLUSION</u>
>
> No, a constructive denial clause is not inconsistent with the perpetuity requirements of section 170(h).

10. <u>IRS Approves Notes to CLAT via LLC</u>. In PLR 201907004 the IRS concluded there was no self-dealing on these facts:

> Trustor transferred certain business interests to trusts established for the benefit of Trustor's descendants (Beneficiary Trusts) in exchange for promissory notes that pay interest only for a term of 30 years, with the total principal amount due at the end of the term. The sole beneficiary or all of the beneficiaries of each Beneficiary Trust are Trustor's descendants.
>
> Trustor assigned the promissory notes to LLC, a State limited liability company. The members of LLC are Trustor, who holds all of the nonvoting interests in LLC, and LLC 2, which holds all of the voting interests in LLC. The members of LLC 2 are Trustor's descendants and each holds interests as individuals.
>
> LLC will hold and administer the promissory notes and receive payments of interest and principal on the promissory notes. Aside from the cash initially contributed by LLC 2 for the voting interests in LLC (which will fund LLC expenses), LLC's sole assets and source of income will be the promissory notes.

> Power to manage the affairs of LLC is vested in the manager, who is selected and may be removed by a vote of the members holding at least a majority of the voting interests in LLC (currently LLC 2, which holds 100 percent of such voting interests). Daughter, who is also the trustee of Trust, is the initial manager of LLC. Daughter holds interests in LLC only in an individual capacity indirectly through her interests in LLC 2, not in her capacity as trustee of Trust.
>
> The members holding nonvoting interests (currently Trustor, who holds 100 percent of such nonvoting interests) possess no management rights or rights to vote on who will be the manager of LLC. LLC may be dissolved only with written approval of all members, whether holding voting or nonvoting interests.
>
> Trust is a charitable lead annuity trust (CLAT) within the meaning of Rev. Proc. 2007- 45, the charitable interest in which is a right to a guaranteed annuity, distributed annually to a public charity that is described in section 501(c)(3). The remainder interests benefit Trustor's descendants. Trustor proposes to fund Trust by transferring Trustor's nonvoting interests in LLC to Trust. The annuity amount shall be paid from Trust's income, including distributions from LLC, and, to the extent income is insufficient

The IRS explanation was as follows:

> Beneficiary Trusts are disqualified persons under section 4946(a)(1)(G) with respect to Trust because they are trusts in which Trustor's descendants, who are disqualified persons under section 4946(a)(1)(D) with respect to Trust, hold more than a 35-percent beneficial interest. Beneficiary Trusts are the obligors of promissory notes given to Trustor in exchange for certain business interests. An act of self-dealing would occur if Trustor transferred the promissory notes to Trust, which would become creditor under the notes. <u>See</u> Treas. Reg. § 53.4941(d)-2(c)(1).
>
> Instead, Trustor assigned the promissory notes to LLC and proposes to transfer nonvoting interests in LLC to Trust. Trust will acquire the nonvoting interests in LLC by gift rather than through a self-dealing transaction. However, if Trust would be considered to "control" LLC within the meaning of Treas. Reg. § 53.4941(d)-1(b)(5), then Trust would be considered to be the creditor, indirectly, under the note by reason of its ownership interest in LLC. <u>See</u> Treas. Reg. § 53.4941(d)-1(b)(8), Example (1).
>
> As holder of the nonvoting interests, Trust will have no management rights or right to vote on the manager of LLC. LLC 2 will own all of the voting interests, giving LLC 2 the right to select and remove the manager LLC. As a holder of nonvoting interests, Trust will have a right to receive distributions only if LLC dissolves or chooses to make current distributions, but the timing and amount of such distributions will be uncertain and could not be compelled by Trust. Only LLC 2, as the holder of the voting interests, may elect or remove the manager of LLC, and such manager will have the sole power to manage the affairs of LLC and determine the timing and amount of distributions. Thus, Trust and Trust's trustees (acting only in such capacity) will not have sufficient votes or positions of authority to cause LLC to engage in a transaction.
>
> Additionally, Trust will not have the power to compel dissolution of LLC since LLC may only be dissolved with written approval of all members, including LLC 2. The power associated with the nonvoting interests of LLC as a necessary party to vote on the liquidation of LLC is not considered equivalent to a "veto power"

> within the meaning of Treas. Reg. § 53.4941(d)-1(b)(5) because the power cannot be exercised over an action relevant to any potential act of self-dealing. Consequently, Trust will not "control" LLC within the meaning of Treas. Reg. § 53.4941(d)-1(b)(5)
>
> Accordingly, Trust's receipt of nonvoting interests in LLC from Trustor will not constitute a loan or extension of credit between a "private foundation" and a "disqualified person" within the meaning of section 4941(d)(1)(B) and Treas. Reg. § 53.4941(d)-2(c) because Trust will not acquire an interest in the promissory note; instead, Trust will acquire nonvoting interests in LLC, with respect to which it will not have any management rights or control over distributions.

11. **<u>Charitable Remainder Trust Not Exempt Under Section 501(c)(3)</u>**. In Letter 201935013 taxpayer created what appears to be a net income CRT (pay lessor of trust income and 7% to spouses until both have died with remainder to charity) and applied on a Form 1023 for tax-exempt status. Of course, the spouse's interests negate exempt status. The IRS expressed no opinion on the trust's status under section 664.

12. **<u>No Self-Dealing Where Marital Trust and Charitable Trust Divided Assets</u>**. A series of complicated transactions "cashing the spouse out" of various trusts were summarized by the IRS in PLR 202016002 as follows:

> The transaction pursuant to the Settlement Agreement, in which Spouse will receive the present value of her life income interests in Irrevocable Trust and Marital Trust, and Charitable Trust will receive the remaining trust assets, may be regarded in substance as an indirect exchange between Spouse and Charitable Trust similar to the one described in Rev. Rul. 72-243. Charitable Trust was not funded upon Decedent's death by Decedent, and no deduction has been or will be allowed under § 170, 545(b)(2), 642(c), 2055, 2106(a)(2), or 2522 with respect to Charitable Trust prior to the contemplated exchange. Therefore, prior to the exchange, Charitable Trust is not a trust described in § 4947(a)(1).
>
> As discussed above, Spouse will receive a gift tax deduction under § 2522 of more than $5,000 for the property deemed transferred by her to Charitable Trust (which will exceed 2 percent of all contributions to Charitable Trust), causing Charitable Trust to be subject to § 4947(a)(1) at that time. Spouse will be a disqualified person with respect to Charitable Trust when the Settlement Agreement is executed, as a substantial contributor to Charitable Trust and as a family member of the creator of Charitable Trust. Section 53.4941(d)-1(a) provides, however, that the term "self-dealing" does not include a transaction between a private foundation and a disqualified person where the disqualified person status arises only as a result of such transaction. Accordingly, §4941 will not apply to the indirect exchange between Spouse and Charitable Trust pursuant to the Settlement Agreement in which Spouse will receive the present value of her life income interest in Irrevocable Trust, GST Exempt Marital Trust, and GST Non-Exempt Marital Trust, and Charitable Trust will receive the remaining trust assets.
>
> Based on the facts submitted and the representations made, we conclude that the indirect exchange between Spouse and Charitable Trust pursuant to the Settlement Agreement will not be treated as an act of self-dealing under § 4941.

That the trust was not yet funded was key.

13. **Eyewear Contribution Flunks Appraisal Requirements**. Campbell v. Commissioner, T.C. Memo. 2020-41, deals with a fascinating charitable contribution strategy summarized by the court as follows:

> This eyewear charitable contribution program involved ZD Products, Inc. (ZD Products), consolidating over 170,000 designer eyeglass frames it possessed into units of approximately 3,432 frames each and selling these units to 50 buyers for $50,000 per unit; each buyer would then purportedly be eligible to donate his or her frames after a minimum one-year holding period to Lions in Sight, a section 501(c)(3) nonprofit organization[4] (or to a different qualified charitable organization of the buyer's choosing), and claim a charitable contribution deduction at the appraised fair market value at the time of donation.

The appraisal was fascinating:

> The initial written appraisal prepared by Marshall & Stevens and dated November 27, 2006 (2006 Marshall & Stevens appraisal), was included with the offering memorandum. The 2006 Marshall & Stevens appraisal described the **[*6]** property that ZD Products requested it value and the property's physical condition as follows:
>
> > **1.3 Description of the Donated Property**
> >
> > The property to be contributed consists of new (unused) Designer Eyewear Products ("Designer Eyewear Products" or "donated property"). The subject property list with description, count and wholesale price originated from Eyewear Designs LTD. Located in Syosset NY. The subject property consists of various styles and designer brand names. These designer brand names include Bill Blass, Elizabeth Arden, Perry Ellis, and Pierre Cardin. The total quantity is 171,600. A sampling of the various brand names and models show that the eyewear brands are still active in the marketplace. These particular designer eyewear product brand names are some of the most well known and long standing eyewear products in the designer eyewear marketplace. They have however have [sic] been discounted over time and are no longer the most current popular styles and brands.
> >
> > **1.4 Physical Condition of the Property**
> >
> > We have not made a personal viewing of the subject property. It is our understanding that the subject property analyzed is in new (unused) condition and that the amount of property or "count" is correct. The current location of the subject property is not known.
>
> The referenced "subject property list" (which was attached to the 2006 Marshall & Stevens appraisal) stated that the "donated property" consisted of 31,950 Bill Blass frames, 23,150 Elizabeth Arden frames, 13,200 Elizabeth Arden "Petites" frames, 33,150 Pierre Cardin frames, 54,350 Perry Ellis frames, and 15,800 Perry Ellis America frames. This list also showed various models within each eyewear brand of varying quantities and wholesale prices. The wholesale price per model **[*7]** ranged from $37 to $80. Using the market approach[7] and on the basis of the wholesale prices with a markup of 35%, Marshall & Stevens opined that the fair market value of the "donated property" as of November 27, 2006, was $11,266,115.

***

> Pursuant to the offering memorandum Marshall & Stevens prepared a followup written appraisal for ZD Products; this appraisal was dated December 26, 2007, and certified by Senior Manager Shane Park at Marshall & Stevens (2007 Marshall & Stevens appraisal). The 2007 Marshall & Stevens appraisal contained the same description and physical condition of the "donated property" as the 2006 Marshall & Stevens appraisal except that the total quantity of eyeglass frames had increased to 349,629 (from 171,600) and included the following additional brand names — Laura Ashley, Eddie Bauer, HSM, Nicole Miller, Dakota Smith, and Bebe.
>
> The inventory list attached to the 2007 Marshall & Stevens appraisal stated that the "donated property" consisted of the same quantity and frame models as the inventory list attached to the 2006 Marshall & Stevens appraisal plus 84,847 Laura Ashley frames, 38,923 Eddie Bauer frames, 583 HSM frames, 6,044 Nicole Miller frames, 1,047 Signature Collection frames,[8] 43,411 Dakota Smith frames, and 3,174 Bebe frames. This list also showed various models within each eyewear brand of varying quantities and wholesale prices. Like the inventory list attached to the 2006 Marshall & Stevens appraisal, the wholesale price per model ranged from $37 to $80. Using the market approach and on the basis of the wholesale prices with a markup of 35%, Marshall & Stevens opined that the fair market value of the "donated property" as of December 26, 2007, was $24,019,826.
>
> On April 9, 2008, Marshall & Stevens sent petitioners a letter stating that it had "made an analysis and valuation of the Fair Market Value of Designer Eyewear Products" and that "as a result of our analysis, we have determined that the Fair Market Value of the Designer Eyewear Products you hold is $225,596 based on" the 2007 Marshall & Stevens appraisal. The 2007 Marshall & Stevens appraisal was attached to the letter.

The court agreed with the IRS that whatever the appraisal was of, it was not of what the taxpayer donated. Indeed, it was impossible to ascertain what the taxpayer donated:

> Although the 2007 Marshall & Stevens appraisal included Mr. Campbell's 3,432 eyeglass frames, we (and the IRS) have no way to determine whether what he alone contributed is overvalued. This is the type of situation that Congress intended to prevent when it codified more than 15 years ago the requirement that a taxpayer claiming a charitable contribution deduction for the donation of property worth more than $5,000 obtain a qualified appraisal for the property contributed. Sec. 170(f)(11)(C) (as amended by the American Jobs Creation Act of 2004, Pub. L. No. 108-357, sec. 883(a), 118 Stat. at 1631).
>
> Tellingly, the 349,629 eyeglass frames that Marshall & Stevens valued varied in price between $37 and $80, yet petitioners could not discern whether Mr. Campbell's 3,432 frames are from the low end of the price spectrum, the high end, or some varying combination. Indeed, the 2012 Miles appraisal highlights the primary defect of the 2007 Marshall & Stevens appraisal. In the 2012 Miles appraisal, 39,709 of the 349,629 eyeglass frames were assigned a value of zero as of December 2007. Might Mr. Campbell's 3,432 frames been a part of the 39,709 frames?
>
> On brief petitioners argue (via requesting that the Court find as fact) that Mr. Campbell purchased and donated a fractional interest, i.e., an undivided 3,432d interest, in the 349,629 frames. The record unmistakably belies this. As an initial

> matter, petitioners have stipulated that Mr. Campbell purchased a single allotment of 3,432 eyeglass frames from ZD Products.

Oddly, the taxpayers also did not receive an appropriate contemporaneous written acknowledgment which is somewhat bizarre. The opinion notes:

> Respondent contends that Lions in Sight's December 28, 2007, letter to Mr. Campbell was not a proper CWA because it did not address the "goods or services" question. We agree (although we recognize that petitioners claim, and it can be inferred from the record, that Mr. Campbell's Lions in Sight donation was not made with the expectation of a quid pro quo). The letter merely acknowledged his "generous gift of prescription eyeware [sic]" and how his contribution would assist Lions in Sight; it made no mention of whether Lions in Sight provided any goods or services in consideration for Mr. Campbell's contribution. As we have stated many times, the CWA must affirmatively state that no consideration was provided for the contributed property regardless of whether a taxpayer actually received any consideration; this is a mandatory requirement and no deduction will be allowed if the CWA does not include such a statement.

Ironically, the taxpayers avoided penalties because the IRS notice of penalties was defective:

> On the basis of the record before us, we hold that respondent has failed to carry his initial burden of production under section 7491(c) to show that he complied with the procedural requirements of section 6751(b). The Civil Penalty Approval Form, although properly signed and dated before the issuance of the notice of deficiency (the first formal communication of penalties to petitioners), does not show separate approval for the section 6662(a) and (h) penalties. The one-page form fails to state with any degree of specificity which penalties should be asserted (and are approved); indeed, all that the form states is that a "[p]enalty will be asserted with the 2008 [y]ear." Section 6751(b)(1) would be meaningless **[*33]** if written supervisory approval of an unspecified penalty was sufficient; examining agents would be free to assert any type of penalty after written supervisory approval was given, an action that section 6751(b)(1) was designed to prevent. Consequently, since respondent has not proffered any other evidence that he complied with the procedural requirements of section 6751(b), petitioners are not liable for the section 6662(a) and (h) accuracy-related penalties.

14. Donation Disallowed Because Appraisal Summary Omitted Basis Information. Loube v. Commissioner, T.C. Memo. 2020-3, involved the contribution of a house for deconstruction to a charitable organization. The taxpayer attached the appraisal to the taxpayer's income tax return but the appraisal summary did not set forth basis which the court held was fatal. The opinion states:

> We have recently held that a taxpayer who fails to disclose "cost or adjusted basis" on its appraisal summary has failed to substantially comply with section 1.170A-13, Income Tax Regs. RERI Holdings I, LLC v. Commissioner, 149 T.C. 1. We decided so because Congress specifically enacted DEFRA's heightened reporting requirements in order to combat inflated charitable deductions by requiring, where reasonably obtainable, the disclosure of "cost or adjusted basis" to "facilitate the Commissioner's efficient identification of overvalued property." Belair Woods, LLC v. Commissioner, at *17. Thus, a taxpayer's failure to provide the "cost or adjusted basis" on an appraisal summary is a failure to substantially comply with DEFRA sec. 155 because it is a failure to "provide[ ] sufficient information to

permit * * * [the Commissioner] to evaluate the[ ] reported contributions, as intended by Congress." Smith v. Commissioner, 2007 WL 4410771, at *20; see also Belair Woods, LLC v. Commissioner, at *15-*20.

In RERI Holdings I, LLC v. Commissioner, 149 T.C. at 2-3, a partnership acquired and donated a future interest in commercial property to a university. The partnership claimed a $33,019,000 charitable contribution deduction on its informational return. Id. The partnership attached to its return a complete appraisal as well as an appraisal summary. Id. at 7. However, the appraisal summary left blank the space for the donor's cost or adjusted basis and provided no explanation for the omission. Id. We held in RERI that the omission of basis from an appraisal summary prevents the appraisal summary from achieving its intended purposes and cannot be excused by substantial compliance. Id. at 16-17.

In Belair Woods, LLC v. Commissioner, at *3-*5, a limited liability company (Belair) entered into a deed of conservation easement with a land trust. The easement covered 141.15 acres of land. Id. Belair claimed a resulting charitable contribution deduction of $4,778,000 on its tax return. Id. at *5-*6. Belair attached an appraisal summary which did not state the cost or the adjusted basis of the property contributed. Id. at *6-*7. Belair also attached a letter indicating that it did not state the basis because "the basis of the property is not taken into consideration when computing the amount of the deduction." Id. at *7. The Court found that Belair did not strictly comply with the regulatory requirement because the appraisal summary did not report the basis and the attached letter failed to provide a sufficient explanation showing why Belair was unable to provide that information. Id. at *11-*12.

Belair's tax matters partner argued that the disclosure in the return had substantially complied because Belair's cost basis in the conservation easement could be effectively derived from several attachments to its partnership tax return: (1) a Schedule L, Balance Sheets per Books; (2) a Schedule M-1, Reconciliation of Income (Loss) Per Books With Income (Loss) Per Return; (3) a section 743(b) election and calculation sheet; and (4) the attached appraisal. Id. at *19. We rejected the tax matters partner's argument because supplying the cost or adjusted basis on the appraisal summary goes directly to the essence of statute. Id. at *15-*16 (citing Bond v. Commissioner, 100 T.C. at 41).

Petitioners contend that attaching the full appraisal to their return provided the necessary information such that they substantially complied. We are not swayed. While it may have been possible for the Commissioner to glean sufficient information from the purchase price and tax information listed in the appraisal, that does nothing to change the fact that Congress specifically passed DEFRA's heightened substantiation requirements so that the Commissioner could efficiently flag properties for overvaluation from the face of appraisal summaries. In so doing, Congress wanted precisely to prevent the Commissioner from having to sleuth through the footnotes of millions of returns. "The IRS reviews millions of returns each year for audit potential, and the disclosure of cost basis on the Form 8283 itself is necessary to make this process manageable. Revenue agents cannot be required to sift through dozens or hundreds of pages of complex returns looking for clues about what the taxpayer's cost basis might be." Belair Woods, LLC v. Commissioner, at *20. "If cost basis is not explicitly disclosed where it is required to be disclosed, the Commissioner will be handicapped in identifying suspicious charitable deductions and deterring taxpayers from 'continu[ing] to play the "audit lottery." ' " Id.(quoting S. Prt. No. 98-169 (Vol. 1), at 444 (1984)). That is why we ruled as we did in RERI and Belair Woods and why we rule as we do now.

The charity itself was interesting:

> Petitioners resided in Maryland when they filed their petition. On or about July 1, 2013, petitioners purchased real property in Potomac, Maryland. The property was purchased for $795,000 and consisted of 0.38 acres of land and a single-family house. Petitioners desired to demolish the house and construct in its place a new residence of their own design.
>
> Second Chance, Inc. (Second Chance), is incorporated under the laws of Maryland and qualifies as a charitable organization under section 501(c)(3). Second Chance performs deconstruction, which is something less than demolition. Where demolition typically results in annihilation of a structure, deconstruction might involve only the removal of furniture, appliances, fixtures, lumber, and other materials. Second Chance sells salvageable material from deconstruction on the open market through its warehouse. But Second Chance's raison d'être is to use the deconstruction process to teach marketable skills to persons facing barriers to employment ranging from limited education to criminal records while environmentally reusing materials that would otherwise end up as landfill debris.
>
> Typically, at the stage where the decision has been made to demolish a structure, the owner will enter into an agreement with Second Chance to allow Second Chance to use the structure for deconstruction. The owner will also make a cash contribution to Second Chance, which covers the upfront costs of Second Chance's deconstruction. Once Second Chance has finished its training and removed salvageable materials, the owner will engage a third party to demolish the structure.
>
> Second Chance contacted petitioners via email on May 3, 2013, explaining its deconstruction program. The email noted that a contribution would generate a tax deduction and included a "Tax Strategy Planning Worksheet". It further noted that a demolition company would still have to be engaged and that the demolition company's cost would be constant in the project.

Footnote 2 states:

> The parties in this case appear to agree that Second Chance's deconstruction did not appreciably reduce petitioners' demolition costs.

The IRS had other issues with the way the appraisal was done – appraising the house versus items in the house – and the IRS also advanced the interesting argument that the gift was a partial interest. The court did not address those arguments. See also <u>Oakhill Woods v. Commissioner</u>, T.C. Memo. 2020-24, with the same issue and result. The Tax Court also rejected a challenge to the regulation's validity:

> This argument is unpersuasive for at least three reasons. First, a taxpayer's "return" for a particular year includes all IRS forms and schedules required to be filed as part of the return. <u>See</u> sec. 1.6011-1, Income Tax Regs. The Form 8283, comprising the appraisal summary, was an essential component of petitioner's return for 2010. By requiring inclusion of information concerning cost basis and acquisition date on the Form 8283, the Secretary complied with Congress' mandate that such data be "include[d] on such return." DEFRA sec. 155(a)(1)(C).

Second, even if Congress were thought to have intended "appraisal summary" and "return" to be mutually exclusive terms, there is nothing in DEFRA section 155 that prohibits the Secretary from requiring that information concerning cost basis and acquisition date be included both on the appraisal summary and elsewhere on the return. Petitioner reads into DEFRA section 155(a)(1)(C) a negative pregnant that is wholly unjustified by the text.

Third, DEFRA section 155(a)(3), which petitioner fails to cite, wholly undermines its argument. That paragraph, captioned "Appraisal summary," provides that, "[f]or purposes of this subsection, the appraisal summary shall be in such form and include such information as the Secretary prescribes by regulations." (Emphasis added.) Congress thus left the Secretary with discretion to require inclusion on Form 8283 of whatever information the Secretary reasonably deemed relevant. See Blau, 924 F.3d at 1270 ("Though the Congress left it to the discretion of the Secretary * * * to impose additional reporting requirements, the Congress specifically identified the basis and the date of acquisition as the bare mini-mum that a taxpayer must provide."). The Code provision governing appraisals makes the depth of the Secretary's discretion plain. See sec. 170(f)(11)(C) (requiring that taxpayers obtain a qualified appraisal and "attach[ ] to the return * * * such information regarding such property and such appraisal as the Secretary may require"). For these reasons we reject petitioner's contention that the regulation violates Chevron step one on the theory that it contravenes "the unambiguous language of the statute."

It seems equally obvious that the regulation satisfies Chevron step two, which requires that the regulation be "based on a permissible construction of the statute." Chevron, 467 U.S. at 843, 104 S.Ct. 2778. When enacting DEFRA Congress decided that the IRS needed disclosure of information--specifically including information concerning cost basis and acquisition date of donated property--in order to combat claims of "excessive charitable deductions" by taxpayers seeking to "play 'the audit lottery.' " S. Prt. No. 98-169 (Vol. 1), supra at 444. Congress accordingly directed the Secretary to issue regulations requiring that taxpayers claiming certain types of charitable deductions attach to their returns an appraisal summary, which "shall be in such form and include such information as the Secretary prescribes by regulations." DEFRA sec. 155(a)(3).

The Secretary reasonably concluded that the information the IRS needed would be most accessible to its examining agents if all of the required information appeared in the same place, namely, on the appraisal summary. The Secretary [*27] therefore issued regulations requiring that information concerning cost basis and acquisition date (as well as nine other types of information) be included in the appraisal summary included with the return. See sec. 1.170A-13(c)(4)(ii), Income Tax Regs. We have no difficulty concluding that the Secretary's requirement to this effect was "based on a permissible construction of the statute." Chevron, 467 U.S. at 843, 104 S.Ct. 2778. We will accordingly deny petitioner's cross-motion for summary judgment insofar as it contends that the regulation is invalid.

C. SECTION 408 — IRAs AND RETIREMENT PLANS

1. Surviving Spouse Permitted To Rollover IRA Proceeds. In PLR 201931006 an IRA had no designated beneficiary and therefore was paid to the estate of the decedent who established the IRA. The surviving spouse was allowed to rollover the IRA. The ruling states:

With respect to your ruling requests, section 408(d)(1) provides that, except as otherwise provided in section 408(d), any amount paid or distributed out of an IRA shall be included in gross income by the payee or distributee, as the case may be, in the manner provided under section 72.

Section 408(d)(3) provides that section 408(d)(1) does not apply to a rollover contribution if such contribution satisfies the requirements of sections 408(d)(3)(A) and (d)(3)(B).

Section 408(d)(3)(A) provides that section 408(d)(1) does not apply to any amount paid or distributed out of an IRA to the individual for whose benefit the account is maintained if: (i) the entire amount received (including money and any other property) is paid into an IRA for the benefit of such individual not later than the 60th day after the day on which he receives the payment or distribution; or (ii) the entire amount received (including money and any other property) is paid into an eligible retirement plan for the benefit of such individual not later than the 60th day after the date on which the payment or distribution is received, except that the maximum amount which may be paid into such plan may not exceed the portion of the amount received which is includible in gross income (determined without regard to section 408(d)(3)).

Section 408(d)(3)(B) provides that section 408(d)(3) does not apply to any amount described in section 408(d)(3)(A)(i) received by an individual from an IRA if at any time during the one-year period ending on the day of such receipt such individual received any other amount described in section 408(d)(3)(A)(i) from an IRA which was not includible in his gross income because of the application of section 408(d)(3).

Section 408(d)(3)(C)(i) provides, in pertinent part, that, in the case of an inherited IRA, section 408(d)(3) shall not apply to any amount received by an individual from such account (and no amount transferred from such account to another IRA shall be excluded from gross income by reason of such transfer), and such inherited account shall not be treated as an IRA for purposes of determining whether any other amount is a rollover contribution.

Section 408(d)(3)(C)(ii) provides that an IRA shall be treated as inherited if the individual for whose benefit the account is maintained acquired such account by reason of the death of another individual, and such individual was not the surviving spouse of such other individual.

Section 1.408-8, Q&A-5, of the Income Tax Regulations, provides that a surviving spouse of an IRA owner may elect to treat the spouse's entire interest as a beneficiary in an individual's IRA as the spouse's own IRA. In order to make this election, the spouse must be the sole beneficiary of the IRA and have an unlimited right to withdraw amounts from the IRA. If a trust is named as beneficiary of the IRA, this requirement is not satisfied even if the spouse is the sole beneficiary of the trust.

In this case, Decedent B's interest in IRA D passed to her estate. Under these circumstances, Taxpayer A, as the surviving spouse of Decedent B, would not generally be permitted to treat the IRA as his own, because he was not named the beneficiary of Decedent B's IRA. However, because Taxpayer A is the administrator and sole heir to Decedent B's estate, for purposes of applying section 408(d)(3)(A) to the IRA, Taxpayer A is effectively the individual for whose benefit the account is maintained. Accordingly, if Taxpayer A receives a

> distribution of the proceeds of the IRA, he may roll over the distribution into his own IRA.

2. Late IRA Rollover Allowed. In Burack v. Commissioner, T.C. Memo. 2019-83, the taxpayer withdrew money from an IRA to buy a new house, intending to repay the money when her existing residence sold. The opinion notes what happened next:

> On Thursday, August 21, 2014, the sale of petitioner's former home closed. On the same day petitioner received a $524,981 Chase Bank cashier's check, drawn from the closing, to redeposit the distribution back into the IRA. The check was made out to "PERSHING FBO NANCY J. BURACK".
>
> Petitioner's financial adviser initially advised her that she could deposit the check into the Pershing account at Bank of New York on Wall Street. But petitioner credibly testified that Capital Guardian later assured her that she could redeposit the distribution into her IRA by overnighting the check to Capital Guardian in North Carolina. On Thursday, August 21, 2014, petitioner overnighted the check to Capital Guardian. The check arrived at Capital Guardian on Friday, August 22, which was 58 days after petitioner received the IRA distribution.
>
> On August 26, 2014, 62 days after petitioner received the IRA distribution, the check was deposited at Pershing into petitioner's IRA account ending in 0946. Both the deposit and the receipt of funds are reflected on the August 2014 Capital Guardian IRA statement. What happened between Capital Guardian's receipt of the check and the deposit at Pershing is not entirely clear.

The court concluded that the failure to redeposit the money was a clerical error:

> In Wood v. Commissioner, 93 T.C. 114 (1989), a taxpayer transferred stock to Merrill Lynch before the expiration of the 60-day rollover period with the instruction that the shares be deposited into his IRA account. But Merrill Lynch's records showed that the shares were deposited into a nonqualified account and rolled over into the IRA after the expiration of the 60-day rollover period. Id. at 117.
>
> In deciding whether the transaction qualified for rollover treatment, we looked at the substance of the transaction and the relationship between the taxpayer and Merrill Lynch. Id. at 120-121. We explained that where book entries conflict with the facts, the facts control. Id. at 121. We found that the transaction was entitled to rollover treatment because Merrill Lynch "had accepted petitioner's Sears stock for deposit to the IRA rollover account and held the stock subject to the IRA trust instrument." Id. We found that Merrill Lynch's failure to record the transfer within 60 days was a bookkeeping error.
>
> While not identical to the present case, Wood is applicable. The substance of the transaction and the relationship between petitioner and Capital [*7] Guardian/Pershing show that the late deposit is attributable to a bookkeeping error. Petitioner never communicated with Pershing about her account. All communication was with Capital Guardian. All of the account statements in the record were generated by Capital Guardian. Petitioner credibly testified that Capital Guardian assured her she could roll over the distribution by overnighting the check to Capital Guardian. It is undisputed that Capital Guardian received the check 58 days after petitioner received the distribution, but the transaction was

> not recorded by Capital Guardian until 62 days after petitioner received the distribution.
>
> Respondent contends that Wood is inapplicable because Pershing was the custodian and, therefore, petitioner should have deposited the check directly with Pershing. However, petitioner's IRA was held with both Capital Guardian and Pershing in a single account bearing the same account number. Petitioner's IRA statement, which was generated by Capital Guardian, listed both Capital Guardian and Pershing. The relationship between Capital Guardian and Pershing is not entirely clear. All of the documentation in the record appears to have been generated by Capital Guardian. The substance of the relationship between petitioner and Capital Guardian shows that Capital Guardian was an appropriate institution for petitioner to send the check to. Petitioner had no communication [*8] with Pershing. None of the IRA account statements in the record were from Pershing; they were all generated by Capital Guardian. All discussions about the rollover contribution were held with Capital Guardian. The June 25, 2014, distribution was received by petitioner from a Capital Guardian IRA as shown by the Capital Guardian account statement. There is no documentation generated by Pershing in the record. The rollover payment was received by Capital Guardian 58 days later. Because the check was received by Capital Guardian during the rollover period but not book-entered by Capital Guardian until after, we find that the late recording is due to a bookkeeping error.

Incidentally, the court added that it also would have allowed hardship relief:

> Rev. Proc. 2003-16, 2003-1 C.B. 359, provides guidance about hardship waivers under section 408(d)(3)(I). It states that an automatic hardship waiver "is granted only: (1) if the funds are deposited into an eligible retirement plan within 1 year from the beginning of the 60-day rollover period; and (2) if the financial institution had deposited the funds as instructed, it would have been a valid rollover." Rev. Proc. 2003-16, sec. 3.03, 2003-1 C.B. at 360.
>
> In this case the funds were deposited into petitioner's IRA within one year. And petitioner credibly testified that Capital Guardian assured her that the rollover could be completed by overnighting the check to Capital Guardian. Capital Guardian received the rollover check on August 22, 2014, 58 days after petitioner received the distribution. As discussed above, Capital Guardian was an appropriate institution for petitioner to send the check to. See supra p. 7. Had Capital Guardian deposited the check as instructed, there would have been a valid rollover. Therefore, petitioner is eligible for the automatic hardship waiver.

3. Court Designation of Spouse As IRA Beneficiary Accepted By The IRS. PLR 201934006 recites these simple facts:

> Decedent died after he was required to begin receiving required minimum distributions from his individual retirement account (Decedent's IRA). At the time of his death, Decedent was married to Taxpayer and their children were listed as the sole beneficiaries of Decedent's IRA. Subsequently, a state court named Taxpayer the sole beneficiary of Decedent's IRA and she represents that she remains the sole beneficiary and has an unlimited right to withdraw amounts from it.

The IRS, without comment, accepted that the spouse was the beneficiary and gave three favorable rulings:

> 1. Decedent's IRA is not an inherited IRA within the meaning of section 408(d)(3)(C) with respect to Taxpayer;
>
> 2. As the sole beneficiary, Taxpayer is eligible to roll over distributions from Decedent's IRA to one or more IRAs established and maintained in her own name pursuant to section 408(d)(3)(A)(i), provided that the rollovers occur no later than the 60th day following the day the proceeds are received; and
>
> 3. Subject to the limitation in section 408(d)(3)(B), Taxpayer will not be required to include in gross income for federal tax purposes, for the year in which a distribution from Decedent's IRA is made, any portion of the proceeds distributed from Decedent's IRA which is timely rolled over to one or more IRAs set up and maintained in Taxpayer's name.

D. SECTIONS 671-678 -- GRANTOR TRUST RULES

1. DING Trusts. State income tax may be avoided if assets may be transferred into a non-grantor trust in such a way as to avoid the transferor making a gift. The typical acronym for such trusts is a DING Trust, for Delaware Incomplete Non-Grantor Trusts, but there is nothing magical about Delaware as the state in which the trust ought be created.

Typically, the grantor of the trust wants to be a beneficiary. Thus, in order to avoid grantor trust status the grantor may receive distributions only at the direction of adverse parties. Generally, some of the grantor's descendants are beneficiaries of the trust and are thus thought to be adverse for income tax purposes, and thus are empowered to make distributions to the grantor.

The grantor also wants the transfer to be incomplete for gift tax purposes. In a string of rulings beginning in 2001 the IRS determined that a testamentary power of appointment in the grantor made the gift incomplete. See e.g. 200148028, 200715005, and others in between. In CCA 201208026 the IRS reversed that position, concluding that the testamentary power of appointment would only affect the remainder interest not the income or present interest. So, the trick is to give the grantor some power that will make the gift incomplete but that will not cause the trust to be a grantor trust for income tax purposes.

One such power is the grantor's power to make distributions in a non-fiduciary capacity pursuant to a fixed and ascertainable standard under Reg. §2511-2 so long as retention of such power does not cause the assets of the trust to be subject to the grantor's creditors (because that would cause the trust to be a grantor trust for income tax purposes, per Rev. Rul. 54-516). Delaware, Ohio, Nevada and Wyoming protect trusts where the donor retains this power.

Another potential power would be to require the grantor's consent before distributions were made to others. This power would pass muster in many of the asset protection states, including Delaware.

In IR-2007-127 (July 9, 2007) the IRS announced it was reconsidering its position on the gift tax consequences to the beneficiaries on the distribution committees. The IRS was likely spooked by comments from a professional group about the tax consequences of DINGs and the government's arguably incoherent ruling position. However, without comment on what learning has been achieved, the IRS began issuing rulings in this area, in March 2013.

New York has enacted legislation providing that DINGs are subject to New York income tax if created by a New York domiciliary even if not a grantor trust for federal income tax purposes. Other states may adopt similar legislation.

PLR 201832008 is typical of current ING trust creation. The distribution of authority is carefully divided and distributed:

> Grantor is the only donor and all property contributed to Trust will be Grantor's separate property under State 1 law. The trustee, Trustee, is a trust company with its headquarter in State 2. Trust is governed by the laws of State 2. Currently, Grantor and Spouse have two minor children, Child 1 and Child 2.
>
> During Grantor's lifetime, at any time or times, Trustee, pursuant to an appointment of the Committee or Grantor, while the Committee is in existence, shall distribute to the Beneficiaries such amounts of net income or principal of Trust as the Committee or Grantor determines. Any appointment, determination, or action by the Committee requires either (i) The unanimous written consent of the then serving members of the Committee, other than Grantor (Unanimous Member Power), or (ii) The written consent of Grantor and a majority of the other then serving members of the Committee (Grantor's Consent Power). In addition, Grantor, in a non-fiduciary capacity, may appoint such amounts of principal to one or more persons in the group consisting of Grantor's descendants, Father, Mother, and Individual, as Grantor deems advisable to provide for such person's health, support, and education. (Grantor's Sole Power). Such power may not be exercised to discharge or satisfy Grantor's legal obligations. Any net income not distributed shall be accumulated and added to the principal of Trust.
>
> If at any time a Committee member fails or ceases to serve then the position of such Committee member shall remain vacant; subject to exception for the appointment of representatives with legal authority to act on behalf of another Committee member.
>
> The Trust agreement provides that if there is no Committee, the trustee (other than a beneficiary-trustee) may pay any one or more of the beneficiaries such amount

> or amounts of the net income and principal for any purpose, even to the extent of all or none, at any time and from time to time, as the trustee determines in his discretion and only with Grantor's written consent, and in making such determinations, the trustee may consider or ignore, in the trustee's discretion, the beneficiaries' other financial resources of any kind.
>
> Initially, Committee consists of Grantor, Representative 1, Representative 2, Father, and Mother. Representatives 1 and 2 act on behalf of Child 1 and Child 2, respectively, until each child reaches majority age. As each of the minor children, Child 1 and Child 2, reaches majority age, that child will become a member of the Committee, replacing his representative. Trust provides that, at any time, members of the Committee, may by unanimous vote add one or more members to the Committee (other than Spouse) provided that such members are beneficiaries of Trust. The Trust agreement, as amended, states that Committee shall be deemed not to exist at any time there are fewer than two members other than Grantor. The Committee shall also be dissolved and cease to exist upon Grantor's death.
>
> Upon Grantor's death, the trustee shall distribute such amounts of trust property as Grantor appoint to or in favor of any one person or more persons or entities, other than Grantor, Grantor's estate, the creditors of Grantor, or the creditors of Grantor's estate, as Grantor may appoint by will (Grantor's Testamentary Power). Such power may not be exercised to discharge or satisfy Grantor's legal obligations.
>
> Upon Grantor's death, the trustee shall divide the then remaining trust property into as many separate shares of equal value as necessary to dispose of the property. Any balance which is not distributed pursuant to Grantor's Testamentary Power shall be distributed as follows: (1) one such equal share to Father, if he is then living; (2) one such equal share to Mother, if she is then living; (3) one such equal share to Individual, if he is then living, and (4) seven such equal shares to Grantor's then living descendants, by right of representation, to be held in further trust for such descendants. If none of the remainder beneficiaries is living upon Grantor's death, any balance which is not distributed pursuant to Grantor's Testamentary Power shall be distributed in equal shares in further trust for the benefit of individuals named in Trust.

The grantor’s contribution to the trust was an incomplete gift:

> In this case, Grantor retained the Grantor's Consent Power over the net income and principal of Trust. Under § 25.2511-2(e), a donor is considered as himself having a power if it is exercisable by him in conjunction with any person not having a substantial adverse interest in the disposition of the transferred property or the income therefrom. The Committee members are not takers in default for purposes of § 25.2514-3(b)(2). They are merely co-holders of the power. Under § 25.2514-3(b)(2), a co-holder of a power is only considered as having an adverse interest where he may possess the power after the possessor's death and may exercise it at that time in favor of himself, his estate, his creditors, or the creditors of his estate. In this case, the Committee ceases to exist upon the death of Grantor. Accordingly, the Committee members do not have interests adverse to Grantor under § 25.2514-3(b)(2) and for purposes of § 25.2511-2(e). Therefore, Grantor is considered as possessing the power to distribute net income and principal to any beneficiary himself because he retained the Grantor's Consent Power.
>
> If the Committee ceases to exist, the Trustee has the power to distribute net income to a beneficiary. However, the Trustee's power is not a condition

> precedent to each Grantor's Consent Power. Each Grantor's Consent Power over income is presently exercisable and not subject to a condition precedent. Thus, the Trustee's power to distribute net income does not cause the transfer of property to be complete with respect to the income interest in Trust for federal gift tax purposes. Therefore, each Grantor is considered as possessing the power to distribute income to any beneficiary himself or herself because he or she retained the Grantor's Consent Power.
>
> Grantor also retained the Grantor's Sole Power over the principal of Trust. Under § 25.2511-2(c), a gift is incomplete if and to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves unless the power is a fiduciary power limited by a fixed or ascertainable standard. In this case, the Grantor's Sole Power gives Grantor the power to change the interests of the beneficiaries. Even though Grantor's power is limited by an ascertainable standard, i.e., health, education, and support, Grantor's power is not a fiduciary power. Accordingly, the retention of the Grantor's Consent Power and the Grantor's Sole Power causes the transfer of property to Trust to be incomplete for federal gift tax purposes.
>
> If the Committee ceases to exist, the Trustee, in its fiduciary capacity, also has the power to distribute principal to one or more beneficiaries. The powers of the Trustee are not conditions precedent to the Grantor's powers. Grantor's Sole Power over principal is presently exercisable and not subject to a condition precedent. Accordingly, Grantor retains dominion and control over the principal of Trust until the Trustee exercises his or her power to appoint principal. *See Goldstein v. Commissioner*, 37 T.C. 897 (1962). Thus, the Trustee's powers to distribute principal do not cause the transfer of property to be complete with respect to the remainder in Trust for federal gift tax purposes. Accordingly, the retention of Grantor's Consent Power and Grantor's Sole Power causes the transfer of property to Trust to be wholly incomplete for federal gift tax purposes.
>
> Further, Grantor retained the Grantor's Testamentary Power to appoint the property in Trust to any persons, other than to the Grantor's estate, Grantor's creditors, or the creditors of Grantor's estate. Under § 25.2511-2(b), the retention of a testamentary power to appoint the remainder of a trust is considered a retention of dominion and control over the remainder. Accordingly, the retention of this power causes the transfer of property to Trust to be incomplete with respect to the remainder for federal tax purposes.
>
> Finally, the Committee members possess the Unanimous Member Power over net income and principal. This power is not a condition precedent to Grantor's powers. Grantor's powers over the net income and principal are presently exercisable and not subject to a condition precedent. Grantor retains dominion and control over the net income and principal of Trust until the Committee members exercise their Unanimous Member Power. Accordingly, the Unanimous Member Power does not cause the transfer of property to be complete with respect to the income interest for federal gift tax purposes. *See Goldstein v. Commissioner*, 37 T.C. 897 (1962); *Estate of Goelet v. Commissioner*, 51 T.C. 352 (1968).

Nonetheless the grantor’s powers did not make the trust taxable to the grantor for income tax purposes.

A distribution from the trust to other than the grantor would be a gift by the grantor. See also PLR 202006002, dealing with community property (one of a series), and PLR 202014001, also part of a series. See also PLR 202017018.

PLR 201908008 is a recent incomplete gift, non-grantor trust ruling, with a charitable feature. The facts presented were otherwise typical:

> On Date, Settlor created Trust, an irrevocable trust, for the benefit of Individual A, Individual B, and Foundation (Eligible Beneficiaries). Trust has an Independent Trustee and an Administrative Trustee. The situs of Trust is State.
>
> Article I(1) of Trust provides that during the life of Settlor, the trustees shall pay so much, if any, of the net income from such trust to or for the benefit of any one or more of the Eligible Beneficiaries, in such equal or unequal shares and to the exclusion of any one or more of the other Eligible Beneficiaries, as the Distribution Committee shall, at any time or from time to time by written instrument delivered to the trustees, direct; provided, however, that the trustees shall not distribute any amount to any of the Eligible Beneficiaries pursuant to any direction of the Distribution Committee unless and until Settlor shall, acting individually and solely in a nonfiduciary capacity, first consent in writing to such direction (Settlor's Consent Power).
>
> Article I(2) provides that the trustees shall be authorized to distribute all or any part of the net income not so paid pursuant to Article I(1) to any one or more of the Eligible Beneficiaries, in such equal or unequal shares and to the exclusion of any one or more of the other Eligible Beneficiaries, as the Independent Trustee shall, at any time or from time to time in the absolute discretion of the Independent Trustee, determine for any purpose.
>
> Article I(3) provides that the trustees shall pay so much, if any, of the principal of such trust to or for the benefit of any one or more charitable organizations, and in such equal or unequal shares, as Settlor shall, at any time or from time to time by written instrument, direct and appoint; provided, however, that this power of appointment shall be a limited power, which shall not be exercisable to any extent in favor of Settlor, Settlor's estate, the creditors of Settlor, or the creditors of Settlor's estate (Settlor's Inter Vivos Limited Power of Appointment).
>
> Any net income not so paid pursuant to Article I shall be accumulated and added to principal.
>
> Article II provides that following Settlor's death, the trustees shall distribute the trust estate to one or more charitable organizations, and in such equal or unequal shares, as Settlor shall direct and appoint; provided, however, that this power of appointment shall be a limited power, which shall not be exercisable to any extent in favor of Settlor, Settlor's estate, creditors of Settlor, or creditors of Settlor's estate (Settlor's Testamentary Limited Power of Appointment). To the extent Trust property is not effectively appointed, the trustees shall distribute such whole or part to such one or more charitable organizations, and in such equal or unequal shares, as the Independent Trustee shall determine in the absolute discretion of the Independent Trustee.
>
> Article III(A) provides that during the life of Settlor, the Distribution Committee shall have the power to direct the trustees as provided in Article I. Following Settlor's death, the PLR-113144-18 3 Distribution Committee shall cease to exist and the person or persons who shall, immediately prior to the death of Settlor, be in office as members of the Distribution Committee shall cease to have any authority, either individually or collectively, to direct the trustees or to exercise any other right or power under Trust.

> Under Article III(B), the initial members of the Distribution Committee are Independent Trustee, Individual A and Individual B. Article III(C) provides that Settlor, or if Settlor at any time is not able to act, the members of the Distribution Committee may appoint successor members to the committee. The Independent Trust also has the power under Article III(D) to appoint members to the committee.
>
> Article III(F) provides that (i) there shall be at least one member of the Distribution Committee in office at all times during Settlor's life and (ii) a majority of the members of the committee shall, at all times during Settlor's life, consist of Eligible Beneficiaries.
>
> Article III(G) provides that if and so long as there shall be more than one member on the Distribution Committee, the committee shall act by majority vote of such members.
>
> Article V(G) provides that there shall not be more than three individuals, or more than two individuals and one corporation in office as trustees of Trust, and none of Settlor, Settlor's husband, and any individual or corporation who is related or subordinate to Settlor or Settlor's husband (within the meaning of § 672(c)) is eligible to serve as trustee of Trust.
>
> Article XII(B)(6) defines the term "charitable organization" to mean and include only an organization (a) that is described in §§ 170(c), 2055(a), and 2522(a); and (b) that shall not, by any action or course of conduct, have so disqualified itself that any charitable deduction that would otherwise be available for federal income, estate or gift tax purposes, in respect of property passing to such organization, would be disallowed.
>
> Settlor has made the following representations. Settlor has not claimed nor will she claim an income tax or gift tax charitable deduction under § 170(c) or 2522(a) for any property transferred by Settlor to Trust at any time, unless and until Trust makes a payment to one or more charitable organizations. No person (including any corporation or trust) other than Settlor is presently expected to make any transfer of property to Trust at any time, so no other charitable deduction will be claimed or available for contributions of property to Trust. Trust will not set aside any amounts for charitable purposes and claim a deduction under § 642(c)(2).

The charitable provisions are not typical. The ruling states that the trust may receive a section 643(c) deduction and that the settlor will not be a disqualified person with respect to the trust because no income tax deduction was claimed. With respect to this point, the ruling states:

> The basic purpose of § 4947 is to prevent these trusts from being used to avoid the requirements and restrictions applicable to private foundations. For purposes of this section, a trust shall be presumed (in the absence of proof to the contrary) to have amounts in trust for which a charitable deduction was allowed if a deduction would have been allowable under one of these sections.
>
> Section 53.4947-1(c)(1)(i) provides that a trust is one which has amounts in trust for which a deduction was allowed under § 642(c) within the meaning of § 4947(a)(2) once a deduction is allowed under § 642(c) to the trust for any amount permanently set aside.

> In Virginian Hotel Corp. v. Helvering, 319 U.S. 523 (1943), the Supreme Court held that "allowed" meant that the taxpayer had taken the deduction and the Commissioner had not challenged it. Id. at 527. Noting that there was "no machinery for formal allowances of deductions from gross income," a deduction being claimed and going unchallenged is the only way in which a deduction could be "allowed."
>
> Trust has both charitable and non-charitable beneficiaries and is not exempt from tax under § 501(a). One of the requirements to qualify as a split-interest trust described in § 4947(a)(2) is that the trust has amounts in trust for which a charitable deduction was allowed to some person (including the trust itself for a charitable set-aside). Settlor has represented that, for the duration of Trust, Trust will not hold any amounts for which a person claimed a charitable deduction for a transfer to Trust, or for which Trust claimed a charitable deduction under § 642(c)(2) for a set-aside. Thus, for Settlor's life, Trust will not qualify as a split-interest trust under § 4947(a)(2). The fact that Settlor may claim a gift tax deduction under § 2522 (or that Trust may claim an income tax deduction under § 642(c)(1) when a charitable distribution from Trust is made is not material, because such amount is not held in Trust when the charitable deduction arises.
>
> Based upon the facts submitted and representations made, we conclude that Settlor will not be a disqualified person with respect to Trust because Trust will not be treated as a split-interest trust within the meaning of §§ 4947(a)(2) and 53.4947-1(c)(1)(i) and, accordingly, the provisions of §§ 507, 508(e), 4941, 4943, 4944, and 4945 shall not apply to Trust during Settlor's life.

2. **Trust as Owner of Another Trust**. A trust would not ordinarily be the owner, for income tax purposes, of another trust. However, such can occur as described in PLR 201633021:

> Original Trust was established by Decedent on Date 1. Decedent died on Date 3.
>
> On Date 2, Court ratified the division of Original Trust into separate trusts for the benefit of each child of Decedent, and his or her spouse and issue. Trust 1 resulted from this division..
>
> The governing document for Trust 1 (Trust 1 Agreement) authorizes Trustee, at any time, to distribute all or any portion of the net income or principal or both of Trust 1 directly to any one or more of the Beneficiaries living at the time of such distribution or to the trustees of any trust of which such Beneficiary is a beneficiary.
>
> Pursuant to the authority granted to the Trustee under the Trust 1 Agreement, the Trustee proposes to transfer funds from Trust 1 to Trust 2 which also benefits Beneficiaries. Beneficiaries rights to distributions under the Trust 2 agreement are the same as those under the Trust 1 Agreement.
>
> The governing document of Trust 2 (Trust 2 Agreement) provides that Trust 1 retains the power, solely exercisable by Trust 1, to revest the net income of Trust 2 in Trust 1; provided, however, that such power shall lapse on the last day of such calendar year.
>
> The Trust 2 agreement provides that income includes (i) any dividends, interest, fees and other amounts characterized as income under § 643(b) of the Code, (ii) any net capital gains realized with respect to assets held less than twelve months,

> and (iii) any net capital gains realized with respect to assets held longer than twelve months.

The ruling holds that Trust 1 will be treated as the owner of Trust 2:

> Trust 1 will be treated as the owner of the portion of Trust 2 over which they have the power to withdraw under § 678(a). Accordingly, Trust 1 will take into account in computing their tax liability those items which would be included in computing the tax liability of a current income beneficiary, including expenses allocable to which enter into the computation of distributable net income. Additionally, Trust 1 will also take into account the net capital gains of Trust 2.

This ruling position offers significant planning opportunities and suggests that trusts should rarely be completely terminated if the trust assets pass to other trusts. For example, suppose grandfather's trust divides into three shares for C1, C2, and C3 each of whom have two children so there are eventually six trusts. If grandfather's trust has retained a dollar of non-income producing property then under state law the trusts could be reformed to allow grandfather's trust to withdraw from the grandchildren's trusts. All of the trusts would be owned by grandfather's trust for income tax purposes which would enable assets to be swapped among the grandchildren's trusts without a taxable transaction. The right to withdraw need not last forever. Similar transactions may occur between GST exempt and non-exempt trusts, and DINGs and completed gift trusts. The fiduciary issues are significant both in agreeing to the necessary trust changes and in not exercising a withdrawal right. It is easier to proceed with trusts stemming from a single source than trusts created contemporaneously by different grantors.

Consider other situations. For example, exempt and non-exempt GST trusts. If they can be "owned" together then tax-free sales between them can occur.

PLR 202022002 considered a trust that contained LLC units:

> According to the representations submitted, Grantors created Trust 1, an irrevocable trust for the benefit of Grantors' children and grandchildren. Grantors transferred Shares to Trust 1. Pursuant to the Trust 1 indenture dated Date 1, Trust 1 was divided into separate trusts for each of Grantors' children and grandchildren.
>
> The Trust 1 indenture prohibits a distribution of the Shares, but allows for distribution of the proceeds from the sale of the Shares. On Date 2, Trust 1 contributed all of its Shares to LLC, a newly formed entity classified as a partnership for federal tax purposes, in exchange for membership interests in LLC. Trust 1 represents that the same restriction placed on the distribution of Shares also restricts the distribution of the LLC interests. Effective Date 3, Trust 1 transferred a portion of its LLC interests to Subtrust. LLC's assets include cash and the Shares. A is the sole beneficiary of Subtrust.
>
> Trust 1 represents that A has the authority to withdraw all of Subtrust's assets when A reaches age 40 except the LLC interests. Pursuant to her withdrawal right, on Date 4, A withdrew all of Subtrust's assets except the LLC interests.

> On Date 5, the trustees of Subtrust agreed to sell a portion of the LLC interests held in Subtrust to Trust 2 in exchange for $a cash and a $b promissory note. Trust 1 represents that Trust 2 is a grantor trust with respect to A under subpart E of part I of subchapter J of the Code. Trust 1 further represents that A has the authority to withdraw the cash and promissory note from Subtrust after the proposed sale.

The IRS determined the transaction was not taxable:

> Based solely on the facts submitted and representations made, we conclude that because A has a power exercisable by herself to vest the proceeds from the sale of Subtrust's LLC interests in herself and that those proceeds are Subtrust's only asset, A will be treated as the owner of Subtrust under § 678. Consequently, the transfer of the LLC interests to Trust 2 is not recognized as a sale for federal income tax purposes because Trust 2 and Subtrust are both wholly owned by A.

This is interesting because it is almost circular.

3. **Beneficiary Deemed Owner Trust**. Section 678 provides:

> (a) General Rule. —A person other than the grantor shall be treated as the owner of any portion of a trust with respect to which:
>
> > (1) such person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself, or
> >
> > (2) such person has previously partially released or otherwise modified such a power and after the release or modification retains such control as would, within the principles of sections 671 to 677, inclusive, subject a grantor of a trust to treatment as the owner thereof.
>
> (b) Exception Where Grantor Is Taxable. Subsection (a) shall not apply with respect to a power over income, as originally granted or thereafter modified, if the grantor of the trust or a transferor (to whom section 679 applies) is otherwise treated as the owner under the provisions of this subpart other than this section.
>
> [emphasis added]

Suppose a beneficiary may withdraw an amount equal to all of the trust's taxable income in any given year (from all of the trust assets) but not the entire trust assets. Ed Morrow refers to this as the BDOT; IRC 678(a)(1) the "*Beneficiary Deemed Owner Trust*" (BDOT), LEIMBERG ESTATE PLANNING NEWSLETTER #2516 (Sept. 5, 2017).

The regulations governing the grantor trust rules (sections 671-679) clearly provide that the reference to "income "unless specifically limited, refers to income determined for tax purposes and not to income for trust accounting purposes. Treas. Reg. §1.671-2(b). In order for the beneficiary to be treated as the owner of the entire trust for income tax purposes under section 678(a)(1), the withdrawal power must apply to all net taxable income during the year, including capital gains. If a beneficiary may withdraw "income" then under applicable state law the concern would be that the trust means income determined for trust accounting purposes which would not typically include extraordinary dividends or capital gains.

To cause the taxable income attributable to the corpus portion of the trust also to be treated as owned by the beneficiary, the withdrawal power must apply with respect to an amount equal to all of the net taxable income. Having the corpus portion of the trust being treated as owned by the beneficiary for income tax purposes is extremely important if the beneficiary wishes to sell assets to the trust and have the transfer treated as a non-recognition event under the reasoning of Rev. Rul. 85-13. In Campbell v. Commissioner, T.C. Memo 1979-495, beneficiaries had the power to cause the trustee to distribute capital gains; beneficiaries did not request and the trustee did not distribute the capital gains income to the beneficiaries, but they were deemed to be the owners of the capital gains income under section 678(a)(1). PLR 201633021 also supports this result.

Income is taxable to a powerholder under section 678(a)(1) whether or not the amount is actually withdrawn. If it is withdrawn, such withdrawal is generally a non-taxable event because it is not a distribution that is reported under the distribution rules for non-grantor trusts. Rev. Rul. 67-241. For instance, section 678(a)(1) applies if the powerholder is a minor for whom a guardian who could exercise the power has not been appointed. Rev. Rul. 81-6 (child could withdraw all income until age 25; minority status irrelevant); Trust No. 3 v. Commissioner, 285 F.2d 102 (7th Cir. 1960)(minor beneficiaries could terminate a trust; that no guardians had been appointed was irrelevant).

What happens if the power is not exercised, as will normally be the case? The trust agreement may provide that failure to withdraw the taxable income amount in a particular year would lapse and could not be exercised in a later year. If so, and if the lapsed power exceeds the greater of "(A) $5,000, or (B) 5 percent of the aggregate value, at the time of such lapse, of the assets out of which, or the proceeds of which, the exercise of the lapsed powers could have been satisfied," the power holder will be treated as having made a gift of the excess amount (unless it is an incomplete gift because of retained powers over the trust), which will mean the property will be included in the powerholder's estate.

Generally, the net taxable income of a trust will be less than 5% of the trust value. To use the full trust value to measure the 5% amount, the beneficiary ought to be able to withdraw the net taxable income amount from all of the trust assets. In Rev. Rul. 66-87 the beneficiary had the power to withdraw accounting income and the 5% element was calculated based just on the accounting income, not all trust assets. Fish v. U.S., 432 F.2d 1278 (9th Cir. 1970), held that the 5% amount, when applied to a power to withdraw "all or part of the net income of the trust for that year" was only 5% of the income, not 5% of the trust assets. The taxpayer argued that because the income payable to the decedent would have been payable either from corpus or income, the entire trust represents "assets out of which, or the proceeds out of which, the exercise of lapsed powers could be satisfied." The court disagreed because for federal tax purposes the distribution would have been a distribution of income.

The IRS cited Fish in Rev. Rul. 85-88 to hold that where a power of appointment is limited to annual trust income the 5 percent test is based on annual trust income, not the amount of trust corpus. Neither Fish nor the Ruling considered the result if the withdrawal right could be from any trust assets. Prudence suggests that a beneficiary should be authorized to withdraw the greater of the net taxable income or 5% of the trust corpus from any of the income or out of the entire corpus of the trust. The right to withdraw may also hang.

Other issues to consider are the rights of creditors of the powerholder and the presence of a true grantor under sections 671-677 which trump section 678.

If the Fish problem can be solved, almost any trust may be taxed to a designated person, for example a person in a state without an income tax. That may not mean the trust is a wholly grantor trust with the benefits of Rev. Rul. 85-13. Does the grantor have rights over corpus? Treas. Reg. § 1.671-3(a)(1) indicates one person can own "income" but not corpus. Put another way, what does the term "portion" mean in section 678? It could mean the "income" portion as opposed to the "corpus" portion or it could mean the undivided interest portion of the trust that a person with a right of withdrawal could withdraw, whether income or corpus. Treas. Reg. § 1.671-3 provides as follows:

> **(a)** When a grantor or another person is treated under subpart E (section 671 and following) as the owner of any portion of a trust, there are included in computing his tax liability those items of income, deduction, and credit against tax attributable to or included in that portion. For example:
>
>> **(1)** If a grantor or another person is treated as the owner of an entire trust (corpus as well as ordinary income), he takes into account in computing his income tax liability all items of income, deduction, and credit (including capital gains and losses) to which he would have been entitled had the trust not been in existence during the period he is treated as owner.
>>
>> **(2)** If the portion treated as owned consists of specific trust property and its income, all items directly related to that property are attributable to the portion. Items directly related to trust property not included in the portion treated as owned by the grantor or other person are governed by the provisions of subparts A through D (section 641 and following), part I, subchapter J, chapter 1 of the Code. Items that relate both to the portion treated as owned by the grantor and to the balance of the trust must be apportioned in a manner that is reasonable in the light of all the circumstances of each case, including the terms of the governing instrument, local law, and the practice of the trustee if it is reasonable and consistent.
>>
>> **(3)** If the portion of a trust treated as owned by a grantor or another person consists of an undivided fractional interest in the trust, or of an interest represented by a dollar amount, a pro rata share of each item of income, deduction, and credit is normally allocated to the portion. Thus, where the portion owned consists of an interest in or a right to an amount of corpus only, a fraction of each item (including items allocated to corpus, such as capital gains) is attributed to the portion. The numerator of this fraction is the amount which is subject to the control of the grantor or other person and the denominator is normally the fair market value of the trust corpus at the beginning of the taxable year in question. The share not treated as owned by the grantor or other person is governed by the provisions of subparts A through D. See the last three sentences of paragraph (c) of this section for the principles applicable if the portion treated as owned consists of an interest in part of the ordinary income in contrast to an interest in corpus alone.

(b) If a grantor or another person is treated as the owner of a portion of a trust, that portion may or may not include both ordinary income and other income allocable to corpus. For example:

> **(1)** Only ordinary income is included by reason of an interest in or a power over ordinary income alone. Thus, if a grantor is treated under section 673 as an owner by reason of a reversionary interest in ordinary income only, items of income allocable to corpus will not be included in the portion he is treated as owning. Similarly, if a grantor or another person is treated under sections 674-678 as an owner of a portion by reason of a power over ordinary income only, items of income allocable to corpus are not included in that portion. (See paragraph (c) of this section to determine the treatment of deductions and credits when only ordinary income is included in the portion.)
>
> **(2)** Only income allocable to corpus is included by reason of an interest in or a power over corpus alone, if satisfaction of the interest or an exercise of the power will not result in an interest in or the exercise of a power over ordinary income which would itself cause that income to be included. For example, if a grantor has a reversionary interest in a trust which is not such as to require that he be treated as an owner under section 673, he may nevertheless be treated as an owner under section 677(a)(2) since any income allocable to corpus is accumulated for future distribution to him, but items of income included in determining ordinary income are not included in the portion he is treated as owning. Similarly, he may have a power over corpus which is such that he is treated as an owner under section 674 or 676 (a), but ordinary income will not be included in the portion he owns, if his power can only affect income received after a period of time such that he would not be treated as an owner of the income if the power were a reversionary interest. (See paragraph (c) of this section to determine the treatment of deductions and credits when only income allocated to corpus is included in the portion.)
>
> **(3)** Both ordinary income and other income allocable to corpus are included by reason of an interest in or a power over both ordinary income and corpus, or an interest in or a power over corpus alone which does not come within the provisions of subparagraph (2) of this paragraph. For example, if a grantor is treated under section 673 as the owner of a portion of a trust by reason of a reversionary interest in corpus, both ordinary income and other income allocable to corpus are included in the portion. Further, a grantor includes both ordinary income and other income allocable to corpus in the portion he is treated as owning if he is treated under section 674 or 676 as an owner because of a power over corpus which can affect income received within a period such that he would be treated as an owner under section 673 if the power were a reversionary interest. Similarly, a grantor or another person includes both ordinary income and other income allocable to corpus in the portion he is treated as owning if he is treated as an owner under section 675 or 678 because of a power over corpus.

(c) If only income allocable to corpus is included in computing a grantor's tax liability, he will take into account in that computation only those items of income, deductions, and credit which would not be included under subparts A through D in the computation of the tax liability of the current income beneficiaries if all distributable net income had actually been distributed to those beneficiaries. On the other hand, if the grantor or another person is treated as an owner solely

> because of his interest in or power over ordinary income alone, he will take into account in computing his tax liability those items which would be included in computing the tax liability of a current income beneficiary, including expenses allocable to corpus which enter into the computation of distributable net income. If the grantor or other person is treated as an owner because of his power over or right to a dollar amount of ordinary income, he will first take into account a portion of those items of income and expense entering into the computation of ordinary income under the trust instrument or local law sufficient to produce income of the dollar amount required. There will then be attributable to him a pro rata portion of other items entering into the computation of distributable net income under subparts A through D, such as expenses allocable to corpus, and a pro rata portion of credits of the trust. For examples of computations under this paragraph, see paragraph (g) of § 1.677(a)-1.

4. <u>Grantor Trusts and Spouses</u>. PLR 201927003 is helpful. Each spouse created a grantor trust. Then spouse one sold a partnership interest to spouse two's trust, and Trust One sold interests to Trust Two. The ruling provides:

> Section 1041(a)(1) of the Code provides that no gain or loss shall be recognized on a transfer of property from an individual to a spouse. Section 1041(b) of the Code provides that, in the case of any transfer described in subsection (a), (1) the property shall be treated as acquired by the transferee by gift, and (2) the basis of the transferee in the property shall be the adjusted basis of the transferor. Because Trust 1 is a grantor trust, assets sold by Trust 1 will be treated for federal tax purposes as sold by Spouse 1. In addition, because Trust 2 is a grantor trust, assets purchased from Taxpayer and Trust 1 will be treated for federal tax purposes as purchased by Spouse 2. Accordingly, based on the information submitted, we rule as follows: (1) Spouse 1 will recognize no gain or loss on the sale by Spouse 1 of a x percent limited partnership interest in Partnership to Trust 2 (§ 1041(a)(1) and Rev. Rul. 85-13). (2) Spouse 1 will recognize no gain or loss on the sale by Trust 1 of a x percent limited partnership interest in Partnership to Trust 2 (§ 1041(a)(1) and Rev. Rul. 85-13). (3) The basis of property acquired from Spouse 1 by Trust 2 will be the same as the adjusted basis in the property in the hands of Spouse 1 (§ 1041(b)(2)). (4) The basis of property acquired from Trust 1 by Trust 2 will be the same as the adjusted basis in the property in the hands of Trust 1 (§ 1041(b)(2)).

E. <u>SECTION 1361 – S CORPORATIONS</u>

F. <u>SECTIONS 2031 and 2512 – VALUATION</u>

1. <u>Minority Interest Valuation</u>. At issue in <u>Kress v. United States</u>, 372 F.Supp. 3d 731 (E.D. Wi. 2019) was the value of Green Pay Packaging, an S corp, for gift tax purposes. The company shares were subject to a stock restriction agreement that the court would have given effect had the taxpayers shown it was comparable to other similar agreements. In particular, the court distinguished between lifetime and testamentary transfers for section 2703 purposes. The opinion states:

> GBP is a family-owned S corporation, and there is no dispute that the Family Transfer Restriction was incorporated into GBP's Bylaws to ensure that the Kress family retains control of the company, to minimize the risk of disruption by a dissident shareholder, to ensure confidentiality of GBP's affairs, and to ensure that all sales of GBP minority stock are to qualified subchapter S shareholders.

The Government argues that the Restriction does not constitute a bona fide business arrangement because it does not prevent a dissident Kress family shareholder from causing management discontinuity by failing to maintain confidentiality or by starting a competing business. But the fact that the objectives of the Restriction are not fail-proof does not mean that the Restriction is not a bona fide business arrangement. The family transfer restriction significantly reduces the risk of these things occurring. To be sure, family transfer restrictions in a company's stock may not be a way to maximize shareholder value. But they are consistent with the goals of maintaining a family business and ensuring that the business continues to provide an opportunity for family members to make a living while at the same time continuing to serve the interests of its employees and the community. These are also bona fide interests of business leaders even though not purely economic. For all of these reasons, the court finds that the family transfer restrictions satisfy the first requirement of § 2703(b).

Under the second requirement, the Restriction cannot be "a device to transfer such property to members of the decedent's family for less than full and adequate consideration in money or money's worth." § 2703(b)(2). C

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Although Chapter 14 is intended to generally address transfer tax avoidance schemes, it is clear from the statute itself that the phrase "members of the decedent's family" unambiguously limits its application to transfers at death. *See* BLACK'S LAW DICTIONARY (10th ed. 2014) (defining "decedent" as a "dead person, especially one who has died recently"); *see also Smith v. United States*, No. C.A. 02-264 ERIE, 2004 WL 1879212, at *6 (W.D. Pa. June 30, 2004) (noting that "one of Congress's primary concerns [in enacting § 2703(b)(2)] was the free passage of wealth to family members through a device that is testamentary in nature"). Although Congress has attempted to amend § 2703(b)(2) to conform with the agency regulations, no such legislation has been enacted. *See Smith*, 2004 WL 1879212, at *6 n. 3 (citing HR Conf. Rep. 1555, 102d Cong., 1st Sess. (1991); The Revenue Bill of 1992, HR Conf. Rep. 11, 102d Cong., 2d Sess. (1992)); *see also Holman*, 601 F.3d at 781 (Bean, J., dissenting) ("I find it telling that members of Congress have failed in their attempts to amend § 2703(b)(2) by substituting the legislative phrase 'members of the decedent's family' with the Commissioner's phrase 'natural objects of the transferor's bounty.'").

In short, I find that Congress has spoken unambiguously to the precise question at issue: § 2703(b)(2) applies specifically to transfers at death. Because Plaintiffs gifted their shares to their family members as living persons, they are, by definition, not decedents. Therefore, § 2703(b)(2) is satisfied. But even were I to conclude that § 2703(b)(2) does apply to *inter vivos* transfers, this would not change the result. For as noted above, the family transfer restrictions serve the bona fide purpose of maintaining family ownership and control of the business, and were not intended as a tax avoidance device.

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Finally, the third requirement is that the Restriction be comparable to similar arrangements entered into by persons in an arms' length negotiation. § 2703(b)(3). The Treasury Regulations provide that Plaintiffs must submit specific evidence showing that the "right or restriction is treated as comparable to similar arrangements entered into by persons in an arm's length transaction if the right or restriction is one that could have been obtained in a fair bargain among unrelated parties in the same business dealing with each other at arm's length." 26 C.F.R. §

> 25.2703–1(b)(4)(i). Though Plaintiffs contend restrictions like the Kress Family Restriction are common in the commercial world, they have not produced any evidence that unrelated parties dealing at arms' length would agree to such an arrangement. For this reason, the Kress Family Restriction does not satisfy the requirement set forth in § 2703(b)(3), and it was improper for Emory to consider the Restriction in determining the discount for lack of marketability.

Interestingly, in passing the court summarizes Rev. Rul. 59-60 a bit wrong in writing:

> "[w]hen the fair market value of stock cannot be determined by examining actual sales of stock within a reasonable time before or after the valuation date, as is the case here, the fair market value is generally determined by analyzing factors that a reasonable buyer and seller would normally consider."

The "or after" seems overbroad.

The taxpayer's experts did not believe the S corporation status affected valuation The court agreed:

> The court finds GBP's subchapter S status is a neutral consideration with respect to the valuation of its stock. Notwithstanding the tax advantages associated with subchapter S status, there are also noted disadvantages, including the limited ability to reinvest in the company and the limited access to credit markets. It is therefore unclear if a minority shareholder enjoys those benefits.

2. **Valuation of Publicly Traded Stock**. CCA 201939002 is pernicious. The co-founder and Chairman of a publicly-traded company funded a GRAT. Subsequently the company announced a merger and its stock appreciated. The ruling states:

> The Internal Revenue Service has reviewed the underlying transaction documents from the year preceding the merger. Such documents include the Corporation A and Corporation B exclusivity agreement, correspondence between Corporation A and Corporation B, and Board meeting minutes. The record as compiled to date supports the position that, as of Date 1, the hypothetical willing buyer of the stock could have reasonably foreseen the merger and anticipated that the price of Corporation A stock would trade at a premium.

The IRS concluded that the gift valuation could be adjusted notwithstanding that the stock was publicly traded. The ruling relies on Silverman – a case involving closely-held stock not yet publicly traded – and Ferguson – an assignment of income case:

> In Silverman v. Commissioner, T.C. Memo. 1974-285, aff'd, 538 F.2d 927 (2d Cir. 1976), cert. denied, 431 U.S. 938 (1977), the petitioners gifted shares of preferred stock while in the process of reorganizing with the intent to go public. The Tax Court rejected the expert testimony presented by the petitioners because the expert failed to take into account the circumstances of the future public sale.
>
> In Ferguson v. Commissioner, 174 F.3d 997 (9th Cir. 1999), aff'g 108 T.C. 244 (1997), the appellate court considered the issue of whether the Tax Court correctly held that taxpayers were liable for gain in appreciated stock under the anticipatory assignment of income doctrine. In Ferguson, taxpayers owned 18 percent of AHC and served as officers and on the board of directors. In late 1987 and early 1988,

> the AHC board of directors contacted and eventually authorized Goldman, Sachs & Co. to find a purchaser of AHC and to assist in the negotiations. By July 1988, Goldman, Sachs had found four prospective purchasers. Shortly thereafter, AHC entered into a merger agreement with DCI Holdings, Inc. With the taxpayers abstaining from the vote, the AHC board unanimously approved the merger agreement. On August 3, 1988, the tender offer was started. On August 15, taxpayers with the help of their broker executed a donation-in-kind record with respect to their intention to donate stock to a charity and two foundations. On September 9, 1988, the charity and the foundations tendered their stock. On September 12, 1988, the final shares were tendered and on October 14, 1988, the merger was completed. The court concluded that the transfers to charity and the foundations occurred after the shares in AHC had ripened from an interest in a viable corporation into a fixed right to receive cash and the merger was "practically certain" to go through. In particular, the court noted that "[t]he Tax Court really only needed to ascertain that as of [the valuation] date, the surrounding circumstances were sufficient to indicate that the tender offer and the merger were practically certain to proceed by the time of their actual deadlines — several days in the future." <u>Ferguson</u>, 174 F.3d at 1004. Consequently, the assignment of income doctrine applied and the taxpayers realized gain when the shares were disposed of by charity and the foundations.
>
> The current case shares many factual similarities with <u>Ferguson</u>, including the targeted search by the Board of Directors of Corporation A to find merger candidates, the exclusive negotiations with Corporation B immediately before the final agreement, the generous terms of the merger, and an agreement that was "practically certain" to go through. While the <u>Ferguson</u> opinion deals exclusively with the assignment of income doctrine, it also relies upon the proposition that the facts and circumstances surrounding a transaction are relevant to the determination that a merger is likely to go through. <u>See Bank One</u> and <u>Kollsman, supra</u>. The current case presents an analogous issue, that is, whether the fair market value of the stock should take into consideration the likelihood of the merger as of the Date 1 transfer of Shares to Trust. The <u>Ferguson</u> and <u>Silverman</u> opinions, as considered by the Tax Court and the Second and Ninth Circuit Courts of Appeal, support the conclusion that the value of stock in Corporation A must take into consideration the pending merger. Accordingly, a value determined on the basis of the selling price as provided under § <u>25.2512-2(b)</u> does not represent the fair market value of Shares as of the valuation date; pursuant to § <u>25.2512-2(e)</u>, other relevant facts and elements of value must be considered in determining fair market value. <u>Under the fair market value standard as articulated in § 25.2512-1, the hypothetical willing buyer and willing seller, as of Date 1, would be reasonably informed during the course of negotiations over the purchase and sale of Shares and would have knowledge of all relevant facts, including the pending merger. Indeed, to ignore the facts and circumstances of the pending merger would undermine the basic tenets of fair market value and yield a baseless valuation.</u>
>
> [Emphasis added.]

The underlined statement will often be false. Many conditions pay prevent the shareholder from discussing a merger, such as confidentiality agreements, securities law provisions. Further, suppose identical facts except that the shareholder was not an officer or director of the company and was not aware of the impending merger. Would that taxpayer's stock have been valued at the traded value, and, if so, why? Suppose the Chairman's spouse had funded a GRAT on the same date and the evidence was that the spouse never participated in or learned about business matters. Different valuation?

The ruling summarizes Treas. Reg. § 25.2512-2(e) as follows:

> Section 25.2512-2(e) provides, in relevant part, that in cases in which it is established that the value per bond or share of any security determined on the basis of the selling or bid and asked prices as provided under § 25.2512-2(b) does not represent the fair market value thereof, then some reasonable modification of the value determined on that basis or other relevant facts and elements of value shall be considered in determining fair market value.

The full subsection reads as follows:

> **(e)** ***Where selling prices or bid and asked prices do not represent fair market value.*** In cases in which it is established that the value per bond or share of any security determined on the basis of the selling or bid and asked prices as provided under paragraphs (b), (c), and (d) of this section does not represent the fair market value thereof, then some reasonable modification of the value determined on that basis or other relevant facts and elements of value shall be considered in determining fair market value. Where sales at or near the date of the gift are few or of a sporadic nature, such sales alone may not indicate fair market value. In certain exceptional cases, the size of the block of securities made the subject of each separate gift in relation to the number of shares changing hands in sales may be relevant in determining whether selling prices reflect the fair market value of the block of stock to be valued. If the donor can show that the block of stock to be valued, with reference to each separate gift, is so large in relation to the actual sales on the existing market that it could not be liquidated in a reasonable time without depressing the market, the price at which the block could be sold as such outside the usual market, as through an underwriter, may be a more accurate indication of value than market quotations. Complete data in support of any allowance claimed due to the size of the block of stock being valued should be submitted with the return. On the other hand, if the block of stock to be valued represents a controlling interest, either actual or effective, in a going business, the price at which other lots change hands may have little relation to its true value.

3. **Transfer of Corporate Opportunity**. Cavallaro v. Commissioner, T.C. Memo. 2014-189, dealt with the valuation of Knight Tool Company and Camelot Systems. Mom and Dad owned Knight which built custom tools. That cyclical business was later supplemented by a new business to make an automated liquid dispensing machine. The two businesses were separate but linked and neither operations nor finances were really separate. Later the family wished it had done some estate planning, described by the court as follows:

> Apart from those minor exceptions, the record does not reflect a consistent or systematic approach to the overall allocations of income and expenses between the two companies, and Knight received less income than it should have as the manufacturer of the machines, while Camelot received more than it should have as the mere seller.[8] Knight provided the equipment and personnel for making the machines, paid the bills, and bore the risk; but profits were disproportionately allocated to Camelot. We attribute this disproportion not to the objective values of the companies but either to the deliberate benevolence of Mr. and Mrs.

Cavallaro toward their sons or else to a non-arm's-length carelessness born of the family relationships of the parties.

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Mr. and Mrs. Cavallaro had prepared wills in the past, but as the combined fortunes of Knight and Camelot improved, they believed that their estate plan should be reviewed. At their request, E&Y accountants began to consider the Cavallaros' estate plan. They observed that the elder Cavallaros' generation possessed value that would eventually be passed down to the three sons (generating estate tax liability), and they considered various strategies to minimize the estate tax, including a "Grantor Retained Annuity Trust", or "GRAT". The E&Y professionals concluded that merging the two companies was a necessary first step to transfer some of Knight's value to the sons through Camelot (and therefore achieve the Cavallaros' estate planning objectives) and to eventually sell the combined entities.

Different advice from the lawyers

Unbeknownst to their E&Y accountants, the Cavallaros had also retained attorneys at the Boston law firm of Hale & Dorr to give them estate planning advice. Mr. and Mrs. Cavallaro had seen a brochure from that firm that included the name of a long-time acquaintance of Mrs. Cavallaro -- Louis Hamel -- and they contacted him. At a meeting in October 1994, Mr. Hamel reviewed the Cavallaros' estates and businesses, and observed the same issue that the accountants had seen -- i.e., that passing to the next generation the value held in the parents' generation (i.e., in Knight) would result in estate tax liability for the estates of Mr. and Mrs. Cavallaro. Accordingly, Mr. Hamel determined that the Cavallaros should claim instead that the value of the CAM/ALOT technology inhered in Camelot, and was thus already owned by the three sons. He based this determination on his conclusion that a one-time transfer of some of the CAM/ALOT technology had occurred in 1987 (when Camelot was created) and that there had also been ongoing transfers from time to time since then. This conclusion was based not on documentation of transfers (there was none) but on a supposed significance that Mr. Hamel contrived from the November 1987 incident in which Mr. Cavallaro had handed the Camelot minute book to Ken Cavallaro at the meeting in Mr. Cirome's office. Mr. Hamel testified at trial that he construed this as a ceremonial or symbolic act for the transfer of the CAM/ALOT technology -- a construction that the evidence does not support.

Given the lack of documentation for the transfer, Mr. Hamel suggested in 1994 that the Cavallaros should prepare affidavits and a "confirmatory" bill of sale attesting to a 1987 transfer, so that when they died and their estate matters were being addressed (by the IRS in particular), there would be evidence that not their company, Knight, but rather Camelot (and through it their sons) had owned the valuable technology underlying the CAM/ALOT machine. An associate of Mr. Hamel interviewed Mr. Cavallaro and Ken Cavallaro; and as to the ownership of the technology, Mr. Cavallaro said nothing to support a 1987 transfer. On the contrary, when Mr. Cavallaro was asked whether there were "ever any agreements either written or oral transferring the technology that Knight Tool developed" he said that he "[n]ever gave it any thought".

At trial, Mrs. Cavallaro confirmed Mr. Cavallaro's recitation of the facts. She was asked: "[H]ow did the transfer of the technology from Knight to Camelot occur? Was there a document signed between you and your husband as the owners of Knight transferring the technology [in 1987]?" In response, Mrs. Cavallaro stated:

"Why would there be a document? Nobody told us there should be a document." Nonetheless, Hale & Dorr prepared affidavits and a "Confirmatory Bill of Sale" that asserted a 1987 technology transfer from Knight to Camelot.

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The accountants initially objected to Mr. Hamel's proposal that the CAM/ALOT technology had been transferred in 1987. They explained that Mr. Hamel's idea was at odds with all the evidence and that it was at odds with Knight's recent amended returns claiming R&D credits for the engineering work on the CAM/ALOT machine.[15]

As a result of Mr. Hamel's correspondence campaign, however, the previously separate tracks of advice -- one from the accountants at E&Y and Mr. McGillivray, and the other from the attorneys at Hale & Dorr -- now came together for the first time. The contradiction was evident to all the professionals: The accountants had assumed no 1987 transfer (and thus believed there was a need for a means to transmit value to the next generation), but the attorneys postulated a 1987 transfer (and subsequent transfers) pursuant to which that value had already been placed in the hands of the next generation. The attorneys eventually prevailed, however, and the accountants acquiesced. Eventually all of the advisers lined up behind Mr. Hamel's suggestion that a 1987 transfer be memorialized in the affidavits and the confirmatory bill of sale. They provided a draft of the documents, which Mrs. Cavallaro read aloud to Mr. Cavallaro. After they reported a few typographical errors, the attorneys prepared final versions, which Mr. Cavallaro and Ken Cavallaro executed on May 23, 1995.

Mr. and Mrs. Cavallaro had been oblivious to the disagreement between the accountants and the lawyers about the transfer of CAM/ALOT technology. All they knew was that their acquaintance and lawyer, Mr. Hamel, advised them that Mr. Cavallaro's act of passing the corporate minute book to Ken Cavallaro in November 1987 warranted their asserting that a technology transfer had occurred. Mr. Cavallaro followed Mr. Hamel's advice and signed the affidavit and confirmatory bill of sale.

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After all the discussion of estate planning issues and of continued CAM/ALOT production for distribution in Europe, in late 1995 Camelot and Knight decided to begin preparations for a merger of the two companies. Accordingly, the Cavallaros engaged E&Y to determine the respective values of the two companies. Timothy Maio of E&Y, using a market-based approach, identified company comparables for Knight and the newly formed merged entity. He explained that he found no suitable comparables for the pre-merger Camelot, and so he did not value it as a stand-alone company. He valued the proposed combined entity as being worth between $70 and $75 million, with Knight's portion of that value being between $13 and $15 million.

On December 31, 1995, Knight and Camelot merged in a tax-free merger with Camelot as the surviving corporation. The stock of the merged company was distributed as follows: Mrs. Cavallaro received 20 shares, Mr. Cavallaro received 18 shares, and 54 shares each were distributed to Ken, Paul and James Cavallaro.[17] Mr. and Mrs. Cavallaro explained that they distributed the shares according to the relative value of each company, as determined by Mr. Maio (that is, 19% of the combined entity to the former shareholders of Knight -- Mr. and Mrs. Cavallaro; and 81% of the combined entity to the founding shareholders of Camelot -- Ken,

> Paul, and James Cavallaro). However, in determining these relative values, Mr. Maio had assumed -- contrary to fact -- that pre-merger Camelot had owned the CAM/ALOT technology. It had not. Consequently, Mr. Maio overstated the relative value of Camelot and understated the relative value of Knight. We find that as a result, by means of this distorted allocation of the stock, Mr. and Mrs. Cavallaro conveyed disproportionate value to their sons in amounts totaling $29.6 million.[18]

The taxpayer experts were disregarded:

> It is the Cavallaros who have the burden of proof to show the proper amount of their tax liability, and neither of the expert valuations they provided comports with our fundamental finding that Knight owned the valuable CAM/ALOT technology before its merger with Camelot. We are thus left with the Commissioner's concession, effectively unrebutted by the party with the burden of proof. The Cavallaros risked their cases on the proposition that Camelot had owned the CAM/ALOT technology (and on a valuation that assumed that proposition), but they failed to prove that proposition (and the evidence showed it to be false). That being so, "[i]t would serve no useful purpose to review our agreement or disagreement with each and every aspect of the experts' opinions." CTUW Georgia Ketteman Hollingsworth v. Commissioner, 86 T.C. 91, 98 (1986). We conclude that Mr. and Mrs. Cavallaro made gifts totaling $29.6 million on December 31, 1995.[36]

There were no penalties however,

> Finally, Mr. and Mrs. Cavallaro persuasively testified that they actually relied in good faith on the advisers' judgment when they structured the merger of Knight and Camelot and when they received inadequate compensation (in the form of shares of the new, merged entity) for their shares of Knight. Neither of the Cavallaros received advanced formal education, and neither was familiar with sophisticated legal matters; and though both had participated in the process of forming a company, neither had previously been a part of a corporate merger. Exercising their best judgment, they sought out professionals with the relevant experience in structuring this type of transaction, and then they acted according to the professionals' recommendations. The value in dispute inhered in invisible, intangible assets, consisting of intellectual property that was mostly not even susceptible of public registration. When their lawyer advised them that it had been transferred, they were hardly in a position to contradict him. In ways that sometimes surprise laymen, the law sometimes deems transfers to have taken place; in fact, the very gifts that we find here are indirect, deemed transfers. If the lawyers and accountants said that a transfer had taken place when Camelot was created in 1987, then from the Cavallaros' point of view, why not? The fault in the positions the Cavallaros took was attributable not to them but to the professionals who advised them. (Since those professionals are not parties here and have not had a full opportunity to explain or defend themselves, we refrain from further comment on them.)

The First Circuit remanded the case to the Tax Court because it found the Tax Court had misstated the nature of the taxpayer's burden of proof. The opinion states:

> In challenging the valuation provided by Bello and relied upon by the Tax Court, the Cavallaros argue that the Tax Court again erred with respect to the burden of proof. The Tax Court stated that the Cavallaros had "the burden of proof to show

the proper amount of their tax liability," but the Cavallaros argue that their burden was actually to establish "that the alleged deficiencies were erroneous." They contend that this "legal error" by the Tax Court led to another: the court refused to consider their evidence that the Bello valuation was "fatally flawed."

Accordingly, our inquiry proceeds in two steps: first, we determine whether the Tax Court misstated the burden of proof; second, we consider whether the court erred in adopting Bello's valuation without considering its alleged defects.

1. Burden of Proof

Although the Tax Court did not misallocate the burden of proof at trial, we agree with the Cavallaros that the Tax Court misstated the content of that burden. The Commissioner's deficiency notices enjoyed a presumption of correctness, and the Cavallaros had the burden of proving by a preponderance of the evidence that they were erroneous. See Rexach, 482 F.2d at 16 n.3; see also Delaney, 99 F.3d at 23 ("[A] tax deficiency assessment is subject to reversal if the taxpayer establishes by a preponderance of the evidence that it was erroneous.").

The Tax Court reasoned that "[i]t is the Cavallaros who have the burden of proof to show the proper amount of their tax liability," but that they could not meet that burden because neither of their valuations (i.e., neither Maio's nor Murphy's) remained standing in light of the Tax Court's finding that Knight, rather than Camelot, owned all of the CAM/ALOT-related technology. Therefore, the Tax Court adopted the Commissioner's Bello valuation in full, even while remarking on its "arguably flawed analysis."

But this statement on the Cavallaros' burden of proof is mistaken as a matter of law. In Taylor, the Supreme Court made it clear that once the taxpayer shows the Commissioner's determination to be "arbitrary and excessive," the taxpayer cannot be made to pay the amount assessed against him -- even if he fails to prove the correct amount of liability he owes. 293 U.S. at 515; see also Rexach, 482 F.2d at 16 n.3 ("[O]nce a taxpayer . . . has borne his burden of proving the Commissioner's determination invalid, he has no further obligation to show . . . how much" money is owed.).

2. Criticisms of The Bello Valuation

The Cavallaros attempted to show that the Commissioner's valuation was "arbitrary and excessive" by challenging Bello's methodology, but the Tax Court refused to hear those challenges on the grounds that, even if the Cavallaros were right, they could not show the correct amount of their tax liability. This runs squarely against the Supreme Court's holding in Taylor.

The Cavallaros should have had the opportunity to rebut the Bello report and to show that the Commissioner's assessment was "arbitrary and excessive."[12] If they succeeded in doing so, the Tax Court should have then determined for itself the correct amount of tax liability rather than simply adopting the Commissioner's position. See Taylor, 293 U.S. at 515-16 (stating that upon determining the Commissioner's valuation to be arbitrary, the Board of Tax Appeals should have conducted a "further hearing" in which it "heard evidence to show whether a fair apportionment might be made and, if so, the correct amount of the tax"); see also Worcester Cty. Tr. Co. v. Comm'r, 134 F.2d 578, 580-81 (1st Cir. 1943) (upon finding the Board's determination of value of a stock to be "arbitrary and excessive," remanding for "further action" on the correct value); Taylor v. Comm'r, 445 F.2d 455, 460 (1st Cir. 1971) ("[Under Taylor,] if a taxpayer proves that a deficiency asserted by the Commissioner is wrong but fails to prove there was no deficiency or the correct figure, the Tax Court cannot accept the Commissioner's admittedly erroneous figure. Instead it must hold a hearing to determine what the correct figure is.").

In accordance with those cases, we remand so that the Tax Court can evaluate the Cavallaros' arguments that the Bello valuation had methodological flaws that made it arbitrary and excessive.[13] If the Tax Court determines that the Commissioner's assessment was arbitrary, then it must determine the proper amount of tax liability for itself.[14] "The court need not, in making this determination, be able to precisely establish the correct figures; reasonable approximations may be employed, provided the findings disclose the method used in calculating the deficiency." Miller v. United States, 296 F.2d 457, 460 (7th Cir. 1961). The court is free to accept in whole or in part, or reject entirely, the expert opinions presented by the parties on the subject. See Silverman, 538 F.2d at 933; see also Helvering v. Nat'l Grocery Co., 304 U.S. 282, 295 (1938). Further, the court may take new evidence, including a new expert valuation.

V. CONCLUSION

For the above-stated reasons, we affirm the Tax Court's determination that the burden of proof was on the taxpayers and its finding that Knight owned the CAM/ALOT-related technology at the time of the Knight-Camelot merger. However, insofar as the court misstated the nature of the Cavallaros' burden of proof, we reverse and remand the case for further proceedings in keeping with this opinion. The extent of any further briefing, hearings, or evidence is left to the Tax Court's sound discretion.

On remand, T.C. Memo 2019-144, the Tax Court was directed to reconsider the valuation report of the IRS expert, Marc Bello:

In accordance with the directive of the Court of Appeals, we evaluate "the Cavallaros' arguments that the Bello valuation had methodological flaws that made it arbitrary and excessive." *Id.* To do so, we ask first whether the $29.7 million value that the Bello report ascribed to the disguised gift is arbitrary and excessive; and we find that it is, on account of one error described below in part II.B.4. That being so, the directive of the Court of Appeals is that we then "must determine the proper amount of tax liability"; and in making that determination we are "free to accept in whole or in part, or reject entirely, the expert opinions presented by the parties on the subject." *Id.* We find that, after we correct the error mentioned above, the Bello report establishes that the value is $22.8 million.

The error in question was described as follows:

When Mr. Bello performed the profit reallocation to normalize the profits between Knight and Camelot, he "calculated the returns available to Camelot based on the expected 4.1% return from the RMA [data] and added a [3.4%9] premium to reflect the strategy of premium pricing and higher profitability [totaling 7.5%] as of the valuation date which would put Camelot in the top 90% for all distributors." The result of this profit allocation calculation is that "both Camelot and Knight were in the top 10% (90th percentile) with regards to profitability within their respective industries."

> On remand, however, the Cavallaros pointed out an error in Mr. Bello's attempt to calculate a profit margin that would place each company in the 90th percentile of its industry. The Cavallaros demonstrated (and the Commissioner acknowledged) that "[t]he RMA data on which he purports to rely reflect that a profit margin of 7.5% would place Camelot in the 88.3rd percentile", not the 90th. The Cavallaros and the Commissioner subsequently corresponded about how Mr. Bello had arrived at the 7.5% value, and it became clear that Mr. Bello had attempted to extrapolate the 90th percentile through a method that was not statistically reliable. Mr. Bello apparently believed that the underlying data was unavailable, so in his attempt to arrive at the 90th percentile, he employed a method that was not statistically correct. He knew only the mean profit margin from the RMA data, 4.1%. He assumed that the mean profit margin would not be that far off from the median or 50th percentile, so he inferred that the theoretical 100th percentile would be 8.2% and that the 90th percentile would be 7.38% (making the 7.5% figure that he employed in the profit reallocation calculation greater than his inferred 90th percentile).
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> Using a profit margin in the 88.3rd percentile versus the 90th percentile makes a substantial difference in the valuation, and therefore a substantial difference in the value of the disguised gift. Using the correct percentage for the actual 90th percentile of net income before tax--9.66%, rather than the 7.5% Mr. Bello used--results in Camelot's having a value of $29.14 million, or 45% of the total value of the combined entities (rather than the $22.6 million value that represented 35% of the combined entities' valuation, as Mr. Bello had computed); and although the Commissioner continues to insist that correction of this error is not necessary or appropriate, he admits that if one does correct for this error, the correction reduces the value of the disguised gift by $6.9 million.
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> We find that this one error in this subcalculation was arbitrary, and we conclude that it did result in an excessive gift tax determination, which must be corrected.

Interestingly, the court had no problem with certain other of the appraiser's actions:

> The Cavallaros allege that Mr. Bello impermissibly followed the Commissioner's instructions and that this bias caused him to fail to interview the principals of Knight and Camelot in his process of valuing them and caused him to fail to do a site visit. The Cavallaros suggest that these failures caused Mr. Bello to misunderstand the nature of Knight and Camelot's businesses, which caused him to overvalue Knight and undervalue Camelot. The Cavallaros say that Mr. Bello "acted like a member of Respondent's trial team, not an expert useful to this Court in making technical determinations". They argue that his bias is further shown by errors in his report.
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> With respect to Mr. Bello's decisions not to not interview the Cavallaros and not to visit Knight and Camelot, he testified credibly that he had enough information to understand the companies, so it was not necessary for him to interview the owners of the business nor to make a site visit many years after the merger at issue. We conclude that any errors in his report were the result of mistake and not bias. We are satisfied that Mr. Bello considered the objective and relevant facts, and we conclude that his valuation was not tainted by overzealous advocacy. Mr. Bello's value for the two combined companies (i.e., $64.5 million) was

> significantly lower than the corresponding values put forth in both of the valuations that the Cavallaros relied upon (i.e., $70-75 million and $72.8 million); and the proportion of that value that Mr. Bello allocated to Knight (i.e., 65%) was well within (and was not at the top of) the range of values that the Cavallaros' accountant postulated in 1994 (i.e., 51% to 85%). See Cavallaro II, at *59-*60. His valuation prompted the Commissioner to make a substantial partial concession before trial (i.e., his valuation caused the Commissioner to change his position in the Cavallaros' favor). Id. We do not find any merit in the Cavallaros' arguments to the effect that Mr. Bello was biased.

Finally, the Tax Court was at some pains to show that this, perhaps, was much ado about little:

> As a check on the reliability of the Bello report, as thus corrected, we make the following simple comparison of the Bello valuation to the valuations relied on by the Cavallaros:
>
> First, any such valuation must begin with the value of the combined premerger companies, and a higher value for the combined companies is disadvantageous to the Cavallaros. Nonetheless, Mr. Bello's combined value ($64.5 million) is lower than the combined value as reckoned by Mr. Maio in 1996 ($70 to $75 million) and by Mr. Murphy in this litigation ($72.8 million). See Cavallaro II, at *32-*33, *37-*39. In comparison to the Cavallaros' valuations, Mr. Bello's $64.5 million valuation is not at all excessive but is more favorable to the Cavallaros.
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> Second, the valuation must determine what portion of that combined value is attributable to Knight. Mr. Bello's conclusion that Knight accounts for 65% of the combined value is easily within the range that the Cavallaros' own accountant (Mr. Goodman from E&Y) estimated in 1994 (before the Cavallaros' lawyers postulated a fictitious transfer of the intangibles): Mr. Goodman said that in a merger "the majority of the shares (possibly as high as 85%) [will] go[] to" the owners of Knight (Mr. and Mrs. Cavallaro). Mr. Bello's 65% represents a fairly conservative valuation within Mr. Goodman's range of a "majority" (i.e., greater than 50%) to "possibly as high as 85%".
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> Third, numbers derived from the Cavallaros' personnel suggest a gift amount not too far off Mr. Bello's. Where a range of possible values is given, we take for this purpose the value within that range that is most favorable to the Cavallaros, as follows: First, to value the combined companies, we use the lower combined value ($70 million) of Mr. Maio's range ($70 to $75 million). Next, for the proportion attributable to Knight, we use the lowest number--51%--from Mr. Goodman's range ("majority" to 85%). Since the owners of Knight received not 51% but only 19% of that value in stock from the merger, we determine that the Cavallaros forfeited in favor of their sons 32% (i.e., 51% minus 19%) of that combined value to which they were entitled. We therefore conclude, under this alternative approach, that they made disguised gifts totaling 32% of the $70 million combined company, or $22.4 million. This amount is reasonably close to the $22.8 amount of the disguised gifts, as calculated after correcting Mr. Bello's computation for the one error that rendered its conclusion arbitrary and excessive, as we explained above in part II.B.4. The corrected $22.8 million value of the disguised gift that is yielded by Mr. Bello's methodology is less than 2% higher than the $22.4 million amount suggested by our rough-and-ready use of the numbers derived from the Cavallaros' own personnel. We think this further validates our conclusion.

4. **Valuation of LLCs**. At issue in Grieve v. Commissioner, T.C. Memo. 2020-28, was the valuation of non-voting interests in two LLCs, Rabbit and Angus, each holding securities. Interests in one were given to a 2 year GRAT, and in the other interests were transferred in exchange for a private annuity. The LLCs were controlled by the transferor's daughter, Margaret. The IRS argued that the voting and non-voting should be valued together, which the court rejected.

> When a gift of property is made, its value at the date of the gift shall be considered the amount of the gift. Sec. 25.2512-1, Gift Tax Regs. We do not engage in imaginary scenarios as to who a purchaser might be. Estate of Giustina v. Commissioner, 586 F. App'x 417, 418 (9th Cir. 2014), rev'g and remanding T.C. Memo. 2011-141. In Olson v. United States, 292 U.S. 246, 257 (1934), the Supreme Court explained:
>
> > Elements affecting value that depend upon events or combinations of occurrences which, while within the realm of possibility, are not fairly shown to be reasonably probable should be excluded from consideration for that would be to allow mere speculation and conjecture to become a guide for the ascertainment of value--a thing to be condemned in business transactions as well as in judicial ascertainment of truth. * * *
>
> Respondent's expert relies upon an additional action, the purchase of the class A units. Mr. Mitchell contends that the economic realities have to be taken into consideration and that the economic stake of the holder of a 99.8% interest of the class B units "dwarfs" that of the holder of the class A units. However, Margaret, the sole owner of the class A units, testified that she had no intention of selling the units. She further testified that if she ever sold the units she would demand a premium much higher than what was estimated in the Mitchell reports. If the class B units were ever sold outside the family, Margaret explained that she would require that she be paid a management fee.
>
> We are looking at the value of the class B units on the date of the gifts and not the value of the class B units on the basis of subsequent events that, while within the realm of possibilities, are not reasonably probable, nor the value of the class A units. See id. In Succession of McCord v. Commissioner, 461 F.3d 614, 629 (5th Cir. 2006), rev'g and remanding McCord v. Commissioner, 120 T.C. 358 (2003), the Court of Appeals for the Fifth Circuit reasoned that there are three types of conditions along the "speculative" continuum: (1) a future event that is absolutely certain to occur; (2) a future event "that is not absolutely certain to occur, but nevertheless may be a 'more . . . certain prophec[y]'"; and (3) "a possible, but low-odds, future event" which is "undeniably a 'less . . . certain prophec[y]'".
>
> Mr. Mitchell's valuations relied on an additional action. He concluded that to determine the value of what a willing buyer would pay and what a willing seller would seek for the class B units, a premium to purchase the class A units has to be taken into account. Elements affecting the value that depend upon events within the realm of possibility should not be considered if the events are not shown to be reasonably probable. Olson, 292 U.S. at 257. The facts do not show that it is reasonably probable that a willing seller or a willing buyer of the class B units would also buy the class A units and that the class A units would be available to purchase. To determine the fair market values of the class B units we look at the willing buyer and willing seller of the class B units, and not the willing buyer and willing seller of the class A units.

It is unclear from the opinion what inspired the IRS to audit these transactions.

5. **Timber Company Valuation**. At issue in Estate of Aaron Jones, T.C. Memo. 2019-101, was the valuation of a timber company, SJTC, organized as a limited partnership, and SSC, an S corporation that is the general partner of SJTC. SJTC owned timberland and supplied more than half of the logs used by SSC which runs a lumber manufacturer. The case is largely a battle of experts with the taxpayer's being more persuasive to the court. The expert reports were described like this:

> A. The Estate's Expert
>
> The estate's valuation expert, Richard Reilly, has performed approximately 100 business valuations of sawmills and timber product companies. Mr. Reilly valued SJTC and SSC as going concerns and relied on an income approach--specifically the discounted cashflow (DCF) method--and a market approach in valuing the units of SJTC and SSC transferred as gifts.
>
> Mr. Reilly concluded that SJTC was worth \$21 million on a noncontrolling, nonmarketable basis, after adjustments and discounts, and he calculated a value of \$380 per unit on the basis of the number of outstanding partnership units. Using that valuation, the noncontrolling, nonmarketable value of the block of limited partner units transferred by Mr. Jones to each of his daughters is \$3,901,715.
>
> Mr. Reilly concluded that SSC was worth \$20 million on a noncontrolling, nonmarketable basis, after adjustments and discounts, and he calculated a value of \$390 per share of class A voting stock on the basis of the number of outstanding shares. He applied a 3% discount for lack of voting rights by relying on empirical studies and arrived at a \$380 value per share of class B nonvoting stock.
>
> B. Respondent's Experts
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> Respondent's valuation expert, Philip Schwab, has performed several privately held business valuations. Mr. Schwab valued SJTC as a going concern and relied on an asset-based approach--specifically the net asset value (NAV) method--and a market approach in valuing one SJTC limited partnership unit. After applying adjustments and discounts, Mr. Schwab determined that the value of SJTC on a noncontrolling, nonmarketable basis was \$140,398,000. He determined a value of \$2,530 per limited partner unit on the basis of the number of outstanding partnership units and a value of \$25,973,611 for the block of units Mr. Jones transferred to each of his daughters.
>
> John Ashbrook was respondent's rebuttal expert with respect to Mr. Reilly's valuation of SSC stock. Mr. Ashbrook previously had reviewed and completed several business valuations, including several sawmills. Mr. Ashbrook challenged Mr. Reilly's use of the April 2009 revised projections and his treatment of SSC's general partner interest in SJTC and the intercompany receivable it held.

The first significant issue before the court was whether SJTC ought be valued using a cash-flow or a net asset value approach. The opinion states:

> SJTC's timberlands are its primary asset, and they will retain and increase in value, even if SJTC is not profitable on a year-to-year basis. See id. at 944. Therefore, it

may be appropriate to consider an asset-based approach in valuing an interest in SJTC. See Estate of Smith v. Commissioner, 1999 WL 1001184, at *5.

SJTC also is an operating company that plants trees and harvests and sells the logs. Cf. Harwood v. Commissioner, 82 T.C. 239, 243, 265 (1984) (holding that a timber company that simply acquired and held timberlands and timber rights for use by its affiliated companies should be valued on the basis of its assets), aff'd, 786 F.2d 1174 (9th Cir. 1986). It expends significant time and effort to ensure that its operation is efficient, including selecting high-quality seedlings, planting them properly, and protecting them once planted. It also practices sustained yield harvesting, which requires the use of sophisticated software to ensure that it could maintain its timberlands over the long term, even if selling the land or harvesting all of the trees would be most profitable in the short term. Thus, SJTC is different from TIMOs, REITs, and other holding or investment companies, and an income approach may be appropriate in valuing an interest in SJTC.

We conclude that SJTC has aspects of both an operating company and an investment or holding company. Because it does not fit neatly into either category, a valuation that combines consideration of SJTC's earnings and assets and weights each appropriately may be necessary, so we must dig deeper into the facts.

***

The parties disagree on two points that bear on whether SJTC would sell its timberlands: (1) whether SJTC could sell its timberlands and (2) whether we should consider SJTC separately or as a single business enterprise with SSC. Respondent contends that circumstances may arise in which SJTC could and would sell its timberlands. The estate argues that holders of blocks of SJTC limited partnership units could not force a sale of its timberlands under the partnership agreement and that SSC, which has the exclusive authority to direct SJTC to make such a sale, would never exercise that authority. Respondent argues that this inappropriately considers specific--rather than hypothetical--buyers and sellers. We disagree. SSC's exclusive authority to exercise control over SJTC under the partnership agreement, its interest in SJTC's continued ownership of the timberlands, see infra, and the restrictions imposed on limited partners under the partnership agreement do not depend on how many limited partners SJTC has or who they are. These restrictions apply to the interest because of the partnership agreement and the rights held by SSC and would be taken into account by any hypothetical buyer and seller of a limited partner interest.

As further support for its position, the estate argues that we should consider SJTC and SSC as a single business operation even though they are separate legal entities. Respondent argues that because SJTC and SSC are separate legal entities, we should ignore their interdependent relationship when valuing them. SSC's continued operation as a sawmill company depended on SJTC's continued ownership of timberlands and there was no likelihood that SSC, as SJTC's general partner, would direct SJTC to sell its timberlands while SSC continued operations as a sawmill. In addition, they had almost identical ownership, and they shared administrative staff. Therefore, on the basis of the facts we found above, we conclude that SJTC and SSC were so closely aligned and interdependent that, in valuing SJTC, it is appropriate to take into account its relationship with SSC and vice versa. Contrary to respondent's objection, this does not ignore the status of SJTC and SSC as separate legal entities but recognizes their economic relationship and its effect on their valuations.

The second significant issue was whether SJTC should be tax affected. The IRS said no. The court accepted the taxpayer's expert's 38% adjustment to earnings:

> In his DCF method Mr. Reilly "tax-affected" SJTC's earnings. To do this he used 38% as a proxy for the combined Federal and State tax burdens that owners of SJTC would bear (treating SJTC in effect as a taxable C corporation, albeit at an individual, not corporate, tax rate), and adjusted both the earnings he used to calculate SJTC's net cashflow and the cost of debt capital he used to determine the appropriate discount rate. He then computed the benefit of the dividend tax avoided by estimating the implied benefit for SJTC's partners in prior years and considering an empirical study analyzing S corporation acquisitions cited in his report. In his guideline publicly traded companies valuation, he used the tax-affected earnings as well, although the metrics he used to compare the companies to SJTC were pretax. Finally, he applied a 22% premium to SJTC's weighted business enterprise value (that is, his weighted DCF method and guideline publicly traded companies method valuations) to reflect that benefit.
>
> Respondent contends that Mr. Reilly improperly adjusted SJTC's value for entity-level taxes even though it is a partnership and, therefore, is not liable for tax at the entity level, and there is no evidence that SJTC would become a taxable C corporation. He further argues that tax-affecting abandons the arm's length formulation of fair market value, in the absence of a showing that two unrelated parties dealing at arm's length would tax-affect SJTC's earnings, because it inappropriately favors a hypothetical buyer over the hypothetical seller. Therefore, it understates the value of a limited partner interest in SJTC. Respondent instead argues that a zero tax rate appropriately reflects SJTC's flowthrough status.
>
> ***
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> While respondent objects vociferously in his brief to petitioner's tax-affecting, his experts are notably silent. The only mention comes in Mr. Schwab's rebuttal report, in which he argues that Mr. Reilly's tax-affecting was improper, not because SJTC pays no entity level tax, but because SJTC is a natural resources holding company and therefore its "rate of return is closer to the property rates of return". They do not offer any defense of respondent's proposed zero tax rate. Thus, we do not have a fight between valuation experts but a fight between lawyers.
>
> We do not find respondent's arguments against Mr. Reilly's methodology convincing. While respondent correctly points out that we rejected the proffered tax-affecting in <u>Gross</u> and later cases, he misconstrues our rationale. In <u>Gross v. Commissioner</u>, 1999 WL 549463, at *10, we concluded that "the principal benefit that shareholders expect from an S corporation election is a reduction in the total tax burden imposed on the enterprise. The owners expect to save money, and we see no reason why that savings ought to be ignored as a matter of course in valuing the S corporation." We then concluded that, on the record in that case, a zero-percent corporate tax rate properly reflected those tax savings, rejecting the expert's offered justifications.[5] More recently, in <u>Estate of Gallagher v. Commissioner</u>, T.C. Memo. 2011-148, 2011 WL 2559847, at *12, <u>supplemented by</u> T.C. Memo. 2011-244, we again rejected tax-affecting because the taxpayer's expert did not justify it but again acknowledged that the benefit of a reduction in the total tax burden borne by S corporation owners should be considered when valuing an S corporation. And in <u>Estate of Giustina v. Commissioner</u>, 2011 WL 2516168, at *6, we rejected tax-affecting in the valuation of a partnership because

> we found the taxpayer's expert's method to be faulty: He used a pretax discount rate to present value post tax cashflow. The question in those cases, as here, was not whether to take into account the tax benefits inuring to a flowthrough entity but how.
>
> We find on the record before us that Mr. Reilly has more accurately taken into account the tax consequences of SJTC's flowthrough status for purposes of estimating what a willing buyer and willing seller might conclude regarding its value. His adjustments include a reduction in the total tax burden by imputing the burden of the current tax that an owner might owe on the entity's earnings and the benefit of a future dividend tax avoided that an owner might enjoy.

Eventually each expert compared SJTC to public companies:

> Both Mr. Reilly and Mr. Schwab also used the guideline public company method for SJTC, which values an interest in a subject company by comparing it to publicly traded companies in the same line of business, combining the resulting value from that method with their other chosen method. Both experts conducted database searches for guideline companies that produced similar groups of companies. In his brief respondent accepted Mr. Reilly's market approach valuation. We do as well and recap it below.
>
> Mr. Reilly chose six guideline companies: Pope Resources, Plum Creek Timber, Potlatch Corp., Rayonier, Weyerhaeuser, and Deltic Timber. He then used four different measures to assess the differences between SJTC and the guideline companies: (1) EBIT, (2) earnings before interest, taxes, depreciation, depletion, and amortization (EBITDDA), (3) revenue, and (4) adjusted tangible book value of invested capital (ATBVIC). ATBVIC is calculated by adding the accounting book value of the interest-holder's equity to the accounting book value of the interest-bearing debt, minus the accounting book values of intangible assets and the timberlands, plus the estimated market value of the timberlands.
>
> Mr. Reilly relied on SJTC's reported and projected earnings for the 2010 fiscal year, the last 12 months before the valuation date, and the historical five-year average, and SJTC's reported and projected revenue for the 2009 and 2010 fiscal years, the last 12 months before the valuation date and the historical five-year average. And he relied on SJTC's ATBVIC for the last 12 months before the valuation date. The estate accepted the timberland valuation submitted by respondent's expert, Christopher Singleton, which concluded that the timberland had a fair market value of $424 million as of the valuation date. Therefore, Mr. Reilly used $424 million as the estimated market value of SJTC's timberlands in calculating ATBVIC.
>
> Mr. Reilly found that SJTC was significantly smaller than the median guideline company measured by revenue and assets in the last 12 months before the valuation date. He also found that SJTC was less profitable than all but one of the guideline companies measured by projected EBITDDA for the 2009 fiscal year, although it was more profitable than any of the guideline companies in terms of the historical five-year average of EBITDDA. Finally, while SJTC projected significant earnings growth between the 2009 and 2013 fiscal years, its revenue decreased at a faster pace than the median guideline company over the previous five years.
>
> To account for the differences between SJTC and the guideline companies, Mr. Reilly selected pricing multiples to apply to SJTC's financial fundamentals for

> EBIT and EBITDDA that were slightly above the guideline company low, for revenue that was slightly under the guideline company low, and for ATBVIC that was below the guideline company low. On the basis of the indicated enterprise values for each measure, Mr. Reilly calculated a weighted enterprise value for SJTC of $107 million on a noncontrolling, marketable basis.

The court followed the same procedure as used with SJTC in valuing SSC.

Finally, the IRS expert had suggested a 30% lack of marketability discount whereas the taxpayer's argued for 35%. Without significant comment the court accepted 35%.

G. SECTION 2032 — ALTERNATE VALUATION AND SECTION 2032A — SPECIAL USE VALUATION

1. New Proposed Alternate Valuation Regulations. [WAITING ON FINAL REGULATIONS.] REG-112196-07. An estate may elect alternate valuation and value its assets as of six months after death for estate tax purposes. If the alternate valuation date is elected, property disposed of before six months after death is valued on the date of the disposition. §2032 was originally enacted in 1935, after the stock market crash of 1929. On April 25, 2008, Treasury issued proposed Regulations to restrict the application of section 2032 by preventing post-death events other than market conditions from being taken into account when valuing the property. Those Proposed Regulations defined market conditions as events outside the control of the decedent, the decedent's executor or trustee, or any other person whose property being valued affected the fair market value of the property. The government's defeat in Kohler v. Commissioner, T.C. Memo. 2006-152, inspired the Proposed Regulations. The Tax Court ruled in Kohler that stock received by an estate in a post-death reorganization should be the property valued on the alternate valuation date and that the restrictions placed on the stock should be taken into account. In its action on decision stating non-acquiescence, the IRS took the view that the court incorrectly applied the regulations by allowing a post-death change in the character of the property to be taken into account when determining the property's value. The IRS thought that the court misapplied Treas. Reg. § 20.2032-1(c)(1), which provides that a tax-free reorganization is not a disposition under section 2032.

The Background portion of the Supplementary Information to the 2011 Proposed Regulations discussed them as follows:

> Generally, paragraph (c)(1)(i) identifies transactions that constitute distributions, sales, exchanges, or dispositions of property. If an estate's (or other holder's) property is subject to such a transaction during the alternate valuation period, the estate must value that property on the transaction date. The value included in the gross estate is the fair market value of that property on the date of and immediately prior to the transaction. The term "property" refers to the property includible in the decedent's gross estate under section 2033.
>
> Sections 20.2032-1(c)(1)(ii) and (c)(1)(iii)(A) identify two exceptions to the rule in § 20.2032-1(c)(1)(i). If either exception applies, the estate may use the 6-month date and value the property held on that date. The exception in § 20.2032-1(c)(1)(ii) applies only to transactions in which an interest in a corporation, partnership, or other entity (entity) includible in the decedent's gross estate is

exchanged for one or more different interests (for example, a different class of stock) in the same entity or in an acquiring or resulting entity or entities during the alternate valuation period. Such transactions may include, without limitation, reorganizations, recapitalizations, mergers, or similar transactions. This exception substitutes a fair market value test for the corporate provisions in the current regulations. Specifically, this paragraph proposes that, if, during the alternate valuation period, the interest in an entity includible in the gross estate is exchanged for a different interest in the same entity, or in an acquiring or resulting entity or entities, and if the fair market value of the interest on the date of the exchange equals the fair market value of the property for which it was exchanged, then the transaction will not be treated as an exchange for purposes of section 2032(a)(1). As a result, the estate may use the 6-month date to value the interest in the same entity or in the acquiring or resulting entity or entities received in the exchange. For this purpose, the fair market values of the surrendered property and received interest are deemed to be equal if the difference between the fair market values of the surrendered property and the received interest does not exceed 5 percent of the fair market value of the surrendered property as of the transaction date. This section has no effect on any other provision of the Code that is applicable to the transaction. For example, the provisions of chapter 14 may apply even if the transaction does not result in a deemed exchange for section 2032 purposes as a result of satisfying the provisions of § 20.2032-1(c)(1)(ii).

Section 20.2032-1(c)(1)(iii)(A) proposes that, if, during the alternate valuation period, an estate (or other holder) receives a distribution from a business entity, bank account, or retirement trust (entity) and an interest in that entity is includible in the decedent's gross estate, the estate may use the 6-month date to value the property held in the estate if the following requirement is satisfied. The fair market value of the interest in the entity includible in the gross estate immediately before the distribution must equal the sum of the fair market value of the distributed property on the date of the distribution and the fair market value of the interest in the entity includible in the gross estate immediately after the distribution. If this requirement is not satisfied, the estate must use the fair market value as of the distribution date and immediately prior to the distribution of the entire interest in the entity includible in the gross estate. For purposes of this section, any distribution is deemed to consist first of excluded property (as defined in § 20.2032-1(d)), if any, and then of included property.

The Proposed Regulations contain a large number of examples. Examples 1 and 3 illustrate the basic position:

Example 1. At D's death, D owned property with a fair market value of $100X. Two months after D's death (Date 1), D's executor and D's family members formed a limited partnership. D's executor contributed all of the property to the partnership and received an interest in the partnership in exchange. The investment of the property in the partnership is a transaction described in paragraph (c)(1)(i)(F) and/or (G) of this section. As a result, the alternate valuation date of the property is the date of its contribution and the value to be included in D's gross estate is the fair market value of the property immediately prior to its contribution to the partnership. The result would be the same if D's estate instead had contributed property to a limited partnership formed prior to D's death by D and/or other parties, related or unrelated to D. Further, the result would be the same if D's estate had contributed the property to a corporation, publicly traded or otherwise, or other entity after D's death and prior to the 6-month date.

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> Example 3. D's gross estate includes a controlling interest in Y, a corporation. During the alternate valuation period, Y issued additional shares of stock and awarded them to certain key employees. D's interest in Y was diluted to a non-controlling interest by Y's issuance of the additional stock. Y's issuance of the stock is a transaction described in paragraph (c)(1)(i)(I) of this section. The value to be included in D's gross estate is the fair market value of D's stock immediately prior to Y's issuance of the additional stock. The result would be the same if D's estate included a minority interest in Y on the date of death and that interest became a controlling interest during the alternate valuation period as the result of Y's redemption of the shares of another shareholder.

The IRS realizes that any recapitalization may result in small value changes. Example 5 illustrates a 5% de minimis rule for reorganizations or recapitalizations, the upshot of which could be an incentive to recapitalize entities automatically if 4.99% is a substantial value savings.

> Example 5. (i) At D's death, D owned common stock in Y, a corporation. Two months after D's death (Date 1), there was a reorganization of Y. In the reorganization, D's estate exchanged all of its stock for a new class of stock in X. On the date of the reorganization, the difference between the fair market value of the stock D's estate received and the fair market value on that date of the stock includible in D's gross estate at death was greater than 5% of the fair market value, as of the date of the reorganization, of the stock D held at death. The reorganization is a transaction described in paragraph (c)(1)(i)(H) of this section and does not satisfy the exception described in paragraph (c)(1)(ii) of this section. Thus, the alternate valuation date is the date of the reorganization and the value to be included in D's gross estate is the fair market value of the stock immediately prior to the reorganization. This result is not affected by whether or not the reorganization is a tax-free reorganization for Federal income tax purposes. The result would be the same if the stock had been held, for example, in an IRA with designated beneficiaries. See paragraph (c)(3)(i)(C) of this section.
>
> (ii) If, instead, the difference between the two fair market values as of the date of the reorganization was equal to or less than 5% of the fair market value, as of the date of the reorganization, of the stock D held at death, the reorganization would satisfy the exception provided in paragraph (c)(1)(ii) of this section. Thus, the alternate valuation date would be the 6-month date. The value to be included in D's gross estate would be the fair market value, determined as of the 6-month date, of the new class of stock in Y that D's estate received in the reorganization.

Conservation easements granted during estate administration are an exception to the general rule. As a result, for purposes of determining both the estate's eligibility to make an election under §2032 and the value of the property on the alternate valuation date, the fair market value of the property as of the date of death must be compared to the fair market value of that property as of the alternate valuation date, in each case as that value is adjusted by reason of the existence of the conservation easement.

Retirement plans are specifically discussed. Alternate valuation is available. The Proposed Regulations provide:

(iii) Distributions from an account or entity in which the decedent held an interest at death.

(A) In general. If during the alternate valuation period, an estate (or other holder of the decedent's interest) receives a distribution or disbursement (to the extent the distribution or disbursement consists of included property, as defined in paragraph (d) of this section) (payment) from a partnership, corporation, trust (including an IRA, Roth IRA, 403(b), 401(k), Thrift Savings Plan, etc.), bank account or similar asset, or other entity (entity), and an interest in that entity is includible in the gross estate, the payment does not result in a distribution under paragraph (c)(1)(i)(I) of this section. However, this rule applies only if, on the date of the payment, the fair market value of the decedent's interest in the entity before the payment equals the sum of the fair market value of the payment made to the estate (or other holder of the decedent's interest in the entity) and the fair market value of the decedent's interest in the entity, not including any excluded property, after the payment. In this case, the alternate valuation date of the payment is the date of the payment, and the alternate valuation date of the decedent's remaining interest in the entity, if any, is the 6-month date (or the transaction date, if any, subsequent to this payment). If this requirement is not met, the payment is a distribution under paragraph (c)(1)(i) of this section, and the alternate valuation date of the decedent's entire interest in the entity is the date of the payment. For purposes of this section, a distribution or disbursement is deemed to consist first of excluded property, if any, and then of included property, as those terms are defined in paragraph (d) of this section.

With respect to the sale of an asset or division of an account, Examples 9-12 are as follows:

Example 9. Husband died owning an interest in a brokerage account titled in the names of Husband and Wife with rights of survivorship. On Husband's death, the account held marketable securities, corporate bonds, municipal bonds, certificates of deposit, and cash. During the alternate valuation period, Wife's stockbroker advised her that the account could not be held under the social security number of a deceased individual. Accordingly, approximately one month after Husband's death, Wife directed the stockbroker to transfer the account into an account titled in Wife's sole name. Because title to the joint account passes to Wife at the moment of Husband's death by operation of law, the transfer of the joint account into an account in Wife's sole name is not a transaction described in paragraph (c)(1)(i) of this section. Accordingly, the value of the assets held in Wife's solely owned account will be includible in Husband's gross estate at their fair market value on the 6-month date. The result would be the same if the brokerage firm automatically transferred title to the account into Wife's name, or if Wife changed the beneficiary designation for the account. Finally, the result would be the same if, instead of an account with a brokerage firm, the assets were held in Husband's retirement account (IRA or similar trust such as a Roth IRA, 403(b) plan, or 401(k) plan) or Wife's ownership of the account was the result of a contract (a beneficiary designation form) rather than operation of law.

Example 10. Assume the same facts as in Example 9 except that, during the alternate valuation period, Wife directed the stockbroker to sell a bond in the account. The sale is a transaction described in paragraph (c)(1)(i)(I)(4) of this section. Wife is an individual described in paragraph (c)(3)(i)(D) of this section. Thus, the alternate valuation date of the bond is the date of its sale. The values to be included in D's gross estate are the fair market value of the bond on date of its sale, and the fair market value of the balance of the account on the 6-month date. The result would be the same if the bond had matured and was retired during the alternate valuation period. The result also would be the same if the bond was held within a retirement account (IRA or similar trust such as a Roth IRA, 403(b) plan, or 401(k) plan).

Example 11. Assume the same facts as in Example 9 except that, during the alternate valuation period, Wife withdrew cash from the account or otherwise received income or other disbursements from the account. Each such withdrawal or disbursement from the account (to the extent it consists of included property as defined in paragraph (d) of this section) is a distribution described in paragraph (c)(1)(i)(I)(4) of this section. Provided that, on the date of each distribution, the fair market value of the account before the distribution (not including excluded property) equals the sum of the included property distributed and the fair market value of the included property in the account immediately after the distribution in accordance with paragraph (c)(1)(iii)(A) of this section, the alternate valuation date for each distribution is the date of the distribution and the alternate valuation date for the account is the 6-month date. The value to be included in the gross estate is the fair market value of each distribution of included property (determined as of the date of distribution) and the fair market value of the account on the 6-month date. The result would be the same if the assets were held in an IRA or similar trust, such as a Roth IRA, 403(b) plan, or 401(k) plan.

Example 12. Husband died with a retirement account, having named his three children, in specified shares totaling 100%, as the designated beneficiaries of that account. During the alternate valuation period, the account was divided into three separate retirement accounts, each in the name of a different child and funded with that child's designated share. The division of the retirement account is not a transaction described in paragraph (c)(1)(i) of this section by reason of paragraph (c)(2) of this section, so the alternate valuation date for each of the new accounts is the 6-month date.

2. **Extension: Third Time Is the Charm**. PLR 201908018 isn't complicated. Decedent died owning farmland. His spouse was not advised by her attorney to make a section 2032A election, and didn't. Later spouse was removed, and an administrator appointed who hired an accounting firm. Accounting firm suggested and the administration filed a "supplemental Form 706" to correct errors, but no section 2032A election. Two strikes. The IRS concluded the estate acted reasonably and in good faith and granted an extension to file a second supplemental Form 706 to make the election. The PLR does not say how the election was finally identified.

3. **Alternate Valuation Election Invalid if Ultimately Date of Death Values Produce Lower Combined Estate and GST Taxes**. Section 2032(c) provides:

(c) Election must decrease gross estate and estate tax. No election may be made under this section with respect to an estate unless such election will decrease—

(1) the value of the gross estate, and

(2) the sum of the tax imposed by this chapter and the tax imposed by chapter 13 with respect to property includible in the decedent's gross estate (reduced by credits allowable against such taxes).

CCA 201926013 deals with an election made expecting the taxes to be less at the alternate valuation date, but after audit adjustments the date of death combined taxes was lower. The CCA concludes the date of death values must be used "even though the 2032 election remains completely valid." The relevance of the election remaining completely valid is unclear.

H. <u>SECTION 2033 – GROSS ESTATE</u>

I. <u>SECTIONS 2035-2038 – RETAINED INTERESTS</u>

1. **<u>Tax Court Strikes A Blow Against Discount Planning</u>**. <u>Estate of Powell v. Commissioner of Internal Revenue</u>, 148 T.C. No. 18 (2017) is a reviewed opinion with eight judges on the majority opinion, two concurring in result only, and seven joining a concurring opinion. What's going on here? The case involved three elements – state law and the actions of an attorney in fact; section 2043; and section 2036(a)(2). The latter is the most significant aspect of the opinion. The opinion reads as if the Tax Court, despairing of Congress or the IRS "doing anything about" discount planning, decided to strike a blow on its own.

The facts were simple. On August 6, 2008, Mrs. Powell's son, as attorney in fact, created a Delaware partnership, NHP Enterprises. On August 8, 2008, again as attorney in fact, the son contributed $10,000,752 to NHP in exchange for a 99% limited partnership interest. Son, as general partner had full control of the partnership which could be dissolved with written consent of all partners. Immediately thereafter, the son assigned the 99% to a CLAT using his power of attorney. By all accounts, Mrs. Powell was incapacitated all this time, and she died on August 15, 2008.

The Court ignored the application of section 2036(a)(1) using the "implied agreement" argument advanced by the IRS. Instead the Court looked to apply section 2036(a)(2).

The taxpayer conceded that funding NHP was not a "bona fide sale for adequate and full consideration." Section 2036(a) states:

> (a) General Rule.—The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), * * * under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death—
>
> (1) the possession or enjoyment of, or the right to the income from, the property, or
>
> (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

May the decedent have the right at death for section 2036 to apply? The Court says no. That the decedent had the power as a limited partner to dissolve the partnership with someone else – the general partner – for a moment prior to the transfer to the CLAT was sufficient to invoke section 2036(a)(2). The transfer would have needed to be more than three years before death to be effective given section 2035.

The Court was worried about 2036(a)(2) workarounds. Footnote 4 to the opinion states:

> Because we express no view on whether the transfer of decedent's cash and securities to NHP was subject to a right described in sec. 2036(a)(1) (or whether enjoyment of those assets was subject to change on the date of decedent's death through the exercise of a power described in sec. 2038(a)), it does not follow that, had NHP's limited partnership agreement been drafted in a way that prevented the application of sec. 2036(a)(2), decedent's gross estate would have been reduced by any discount applicable in valuing the limited partner interest issued in exchange for those assets.

The Court also determined that the transfer to the CLAT was invalid under applicable state law – California – because the power of attorney did not specifically authorize gifts (beyond the annual exclusion) which is required in California to confer a broad gift power. Thus the NHP units were also included in the decedent's estate.

Concurring that there was no double inclusion led the majority to expound upon section 2043 with the minority writing that the court should have applied a simple "recycling of value" theory. The concurring opinion states:

> The Court correctly concludes that section 2036(a)(2) applies here. See op. Ct. pp. 14–21 (relying on Estate of Strangi v. Commissioner, T.C. Memo. 2003–145, 85 T.C.M. (CCH) 1331, aff'd on other grounds, 417 F.3d 468 (5th Cir. 2005)). The decedent clearly "made a transfer" of the $10 million in cash and securities. And she clearly retained the proverbial "string" that pulls these assets back into her estate.
>
> But the Court concludes, see op. Ct. p. 22, that section 2036(a) does not require "the inclusion in the value of decedent's gross estate of the full date-of-death value of the cash and securities," while admitting that the statute, "read in isolation, would require that result." See Estate of Thompson v. Commissioner, T.C. Memo. 2002–246, 84 T.C.M. (CCH) 374, 386 ("Section 2036(a) effectively includes in the gross estate the full fair market value * * * of all property transferred in which the decedent had retained an interest." (Emphasis added.)). Instead, the Court holds that section 2036(a)(2) brings into the gross estate a much smaller sum: the value of the cash and securities ($10 million) minus the value of the limited partnership interest that the decedent got in exchange. Otherwise, the Court says, the $10 million would be included in her estate twice: first via section 2036(a)(2) and again via her partnership interest, which would be separately includible as property of the estate under section 2033.
>
> This is where I part company with the Court, because I do not see any "double inclusion" problem. The decedent's supposed partnership interest obviously had no value apart from the cash and securities that she allegedly contributed to the partnership. The partnership was an empty box into which the $10 million was notionally placed. Once that $10 million is included in her gross estate under section 2036(a)(2), it seems perfectly reasonable to regard the partnership interest as having no distinct value because it was an alter ego for the $10 million of cash and securities.

> This is the approach that we have previously taken to this problem. See Estate of Thompson, 84 T.C.M. (CCH) at 391 (concluding that the decedent's interest in the partnership had no value apart from the assets he contributed to the partnership); Estate of Harper v. Commissioner, T.C. Memo. 2002–121, 83 T.C.M. (CCH) 1641, 1654; cf. Estate of Gregory v. Commissioner, 39 T.C. 1012, 1020 (1963) (holding that a decedent's retained interest in her own property cannot constitute consideration under section 2043(a)). And this is the approach that I would take here. There is no double-counting problem if we read section 2036(a)(2), as it always has been read, to disregard a "transfer with a string" and include in the decedent's estate what she held before the purported transfer—the $10 million in cash and securities.
>
> Rather than take this straightforward path to the correct result, the Court ad-opts as the linchpin of its analysis section 2043(a). Neither party in this case advanced any argument based on section 2043(a); indeed, that section is not cited in either party's briefs. And as the Court recognizes, see op. Ct. p. 28, we have not previously applied section 2043(a), as the Court does here, to limit the amount includible in a decedent's gross estate under section 2036(a). See, e.g., Estate of Harper, 83 T.C.M. (CCH) at 1654 (ruling that section 2043(a) "is inapplicable where, as here, there has been only a recycling of value and not a transfer for consideration").
>
> Invoking section 2043(a), the Court divides the $10 million into a "doughnut" and a "doughnut hole." The "doughnut" consists of the limited partnership interest allegedly received by the decedent; on the Court's theory, this is pulled back into the gross estate via section 2035 or 2038, and its value then included under section 2033. As a result, section 2036(a), paired with section 2043(a), has the much-reduced function of bringing back into the gross estate, not the full value of the $10 million as that section by its terms requires, but only "the amount of any discounts (that is, the doughnut holes) allowed in valuing the partnership interest." See op. Ct. pp. 26–27. This theory seemingly validates the estate's claimed discount for lack of marketability, which seems highly suspect on the facts presented.
>
> The Court's exploration of section 2043(a) seems to me a solution in search of a problem. It is not necessary; the parties did not think it was necessary; and our prior cases show that it is unnecessary. And even if the section 2043(a) issue were properly presented, I am not sure that the Court's application of that provision is correct. It is far from clear to me that the decedent's partnership interest—a consequence of the now-disregarded transfer—can constitute "consideration in money or money's worth" within the meaning of section 2043(a).

If there is no persuasive non-tax reason for the entity, and ownership is surrendered within three years of death, then avoiding section 2036(a)(2) is difficult. One approach is to limit the decedent's rights over the entity in the first place. For example, the client could add assets to a trust that lacks any current beneficiaries. The client would retain a testamentary power of appointment thus making the gift incomplete but the assets would be includable in the client's estate. The trustee would engage in the discount planning, presumably under specific authority in the trust. The decedent would never have had any liquidation right or other section 2036(a)(2) right unless such were somehow imputed through the trust to the grantor.

Another approach is to sell the decedent's interest in the entity. The issue there is whether if the sale is for less than would be included in the decedent/seller's estate did the decedent/seller receive full consideration. In United

States v. Allen, 293 F.2d 916 (10th Cir. 1961) the decedent created a trust reserving 3/5ths of the income for life; many years later she sold the income interest for far less than the value of 3/5ths of the trust. The court held that was an inappropriate loophole because – under the 1939 Code – a taxpayer could keep income for most of the taxpayer's life and then sell close to death for a fraction of what otherwise would be included.

In trying to understand the implications of Powell, the case of Estate of Frank D. Streightoff, T.C. Memo. 2018-178, should be considered. Ultimately an 18% lack of marketability discount was allowed, and the section 2036 issue which might have been dispositive was not. The argument by the estate was that the transfer was an assignee interest, which was rejected. The opinion states:

> The parties disagree as to the type of interest that must be valued and included in the value of decedent's gross estate. [footnote omitted]
>
> The estate contends that the agreement created an assignee interest in decedent's limited partnership interest under Texas State law and the partnership agreement. It contends that it valued and reported decedent's interest in the revocable trust correctly as an assignee interest on Schedule G of its tax return. Respondent contends that the agreement did not create an assignee interest held by the revocable trust. Respondent argues that decedent transferred his 88.99% limited partnership interest to the revocable trust and the value to be included in the value of the gross estate should be that of a limited partnership interest.
>
> We need to determine whether the interest decedent transferred to the revocable trust was a limited partnership interest or an assignee interest. Generally, State law determines the property interest that has been transferred for Federal estate tax purposes. See McCord v. Commissioner, 120 T.C. 358, 370 (2003), rev'd and remanded on other grounds, 461 F.3d 614 (5th Cir. 2006). TRLPA (as in effect for the relevant period) provides that a partnership interest is personal property and is assignable, in whole or in part, unless the partnership agreement provides otherwise. Tex. Rev. Civ. Stat. Ann. art. 6132a-1, secs. 7.01 and 7.02(a)(1) (West). An assignee of a partnership interest is entitled to receive, to the extent assigned, allocations of income, gain, loss, deduction, credit, or similar items, and to receive distributions to which the assignor is entitled, but an assignment does not entitle the assignee "to become, or to exercise rights or powers of, a partner". Id. sec. 7.02(a)(2) and (3). The assignee may become a limited partner, with all rights and powers of a limited partner under a partnership agreement, in the manner that the partnership agreement provides or if all partners consent. Id. sec. 7.04(a) and (b).
>
> Although we consult State law to determine what property interests were transferred, our inquiry may not end there. See McCord v. Commissioner, 120 T.C. at 371. The Federal tax effect of a particular transaction is governed by the substance of the transaction rather than its form. Frank Lyon Co. v. United States, 435 U.S. 561, 573 (1978). The doctrine that the substance of a transaction will prevail over its form has been applied in Federal estate and gift tax cases. See Heyen v. United States, 945 F.2d 359, 363 (10th Cir. 1991); Estate of Murphy v. Commissioner, T.C. Memo. 1990-472. In particular, we have indicated a willingness to look beyond the formalities of intrafamily partnership transfers to determine what, in substance, was transferred. See Kerr v. Commissioner, 113 T.C. 449, 464-468 (1999), aff'd, 292 F.3d 490 (5th Cir. 2002). We will consider both the form and the substance of decedent's transfer to the revocable trust to

> determine whether the property interest transferred was an assignee interest or a limited partnership interest.
>
> ***
>
> We conclude that the form of the agreement establishes that decedent transferred to the revocable trust a limited partnership interest and not an assignee interest. The economic realities underlying the transfer of decedent's interest also support our conclusion that the transferred interest should be treated as a limited partnership interest for Federal estate tax purposes. This is because we conclude that regardless of whether an assignee or a limited partnership interest had been transferred, there would have been no substantial difference before and after the transfer to the revocable trust. See Kerr v. Commissioner, 113 T.C. at 467-468. Pursuant to Streightoff Investments' partnership agreement only the general partner had the right to direct the partnership's business; neither limited partners nor assignees had managerial rights. The partnership agreement provided that assignees had no rights to any information regarding the business of the partnership or to inspection of the books or records of the partnership. However, this distinction made no difference in this case because Ms. Streightoff was both a partner entitled to information regarding Streightoff Investments and the trustee of the revocable trust.
>
> The partnership agreement provided that an "unadmitted assignee" did not have the right to vote as a limited partner. In Kerr v. Commissioner, 113 T.C. at 467, we determined that the only real difference between the rights of a limited partner and those of an assignee was the right to vote on partnership matters, and we concluded that this difference was not significant. We held that under such circumstances the transferred interest should be valued as a limited partnership interest rather than as an assignee interest. Id. Here, we conclude similarly that whether the revocable trust held the voting rights associated with a limited partnership interest would have been of no practical significance. There were no votes by limited partners following the execution of the agreement. Additionally, during his life decedent held the power to revoke the transfer to the revocable trust. If he had revoked the transfer, he would have held all the rights of a limited partner in Streightoff Investments, including the right to vote on partnership matters. Also, Streightoff Management as the general partner could have treated the holder of an assignee interest as a substitute limited partner. Under the facts and circumstances of this case, there was no difference in substance between the transfer of a limited partnership interest in Streightoff Investments and the transfer of an assignee interest in that limited partnership interest. See id.; Astleford v. Commissioner, T.C. Memo. 2008-128, slip op. at 16. Accordingly, as a matter of both form and substance, the interest to be valued for estate tax purposes is an 88.99% limited partnership interest in Streightoff Investments.

The Fifth Circuit affirmed, noting that even if an assignee interest had been transferred the valuation would have been the same. Streighthoff v. Commissioner, 954 F.3d 713 (5th Cir. 2020). The Fifth Circuit held:

> *Economic Substance*. From an economic reality standpoint, we also agree with the tax court's alternative substance over form rationale. Estate of Streightoff, 2018 WL 5305054, at *7 ("[R]egardless of whether an assignee or a limited partnership interest had been transferred, there would have been no substantial difference before and after the transfer to the revocable trust."). Assuming we were to accept the Estate's argument that the Assignment conveyed an unadmitted assignee interest as a matter of form, the substance of the transaction will

> nonetheless prevail. The substance over form doctrine permits a court to determine a transaction's characterization according to its "underlying substance of the transaction rather than its legal form." Southgate Master Fund, 659 F.3d at 480. Here, looking beyond the formalities of this intrafamily transfer, the Assignment lacks economic substance outside of tax avoidance. Griffin v. United States, 42 F. Supp. 2d 700, 703 (W.D. Tex. 1998) ("[E]ven if a transaction falls within the literal requirements of the tax statute, the transaction will be disregarded . . . if it has no business purpose or economic effect other than the creation of tax deductions, or if its only purpose is tax avoidance."). While SILP limited partners appear to enjoy several managerial and oversight powers that unadmitted assignees do not6, there were no practical differences after the Assignment was executed. Other than Elizabeth, there is no record of SILP's limited partners, the decedent's children, exercising their partnership rights or responsibilities. For example, this partnership held no meetings or votes, nor was there any attempt to remove Streightoff Management as SILP's general partner. Without genuine nontax circumstances present, the Assignment is the functional equivalent of a transfer of limited partnership interest. See Kerr, 113 T.C. at 467 (Under similar facts, the court held that "[t]he objective economic realities underlying the transfers" support that "there were no significant differences . . . between the rights of limited partners and assignees."); see also Streightoff, 2018 WL 5305054, at *7.

2. **<u>Application of Section 2043 to Defective FLP Transfer</u>**. The 30,000 foot view of <u>Moore v. Commissioner</u>, T.C. Memo. 2020-40, is set out by Judge Holmes of the Tax Court as follows:

> Howard Moore was born into rural poverty but over a long life built a thriving and very lucrative farm in Arizona. In September 2004 he began negotiating its sale, but his health went bad. He was released from the hospital and entered hospice care by the end of that year.
>
> Then he began to plan his estate.
>
> What his lawyer came up with was quite complex--a combination of five trusts and a partnership--and it required him to contribute most of his farm to the partnership. His stated reason was to protect the farm from various business risks and bring his sometimes fractious family together to learn to manage the business without him. But five days after the partnership received part ownership of the farm, Moore sold it. And even after the sale, Moore stayed on the farm and directed its operations until he died.
>
> The key question we have to answer is whether Moore's plan works to reduce the size of his taxable estate. We also have to figure out whether Moore's efforts to reduce the size of his taxable estate resulted in taxable gifts.

In a nutshell, the court concluded that the taxpayer retained control of the farm, and had no bona fide, non-tax reasons for the FLP or transfer, and included it in his estate. But then the court went on to discuss section 2043 in the most detailed way yet by the Tax Court. That discussion is worth consideration for planning purposes:

> a. <u>The Problem of Section 2043(a)</u>
>
> The root of this problem is that section 2043 prohibits the Commissioner from just adding the proceeds from the sale of Moore's farm to his gross estate. It requires instead a more complicated set of calculations when there are

transactions--like the transfer of four-fifths of the farm from the Living Trust to the FLP--that fall within section 2036. Section 2043(a) says (with the key word italicized)

> If any one of the transfers * * * described in sections 2035 to 2038, inclusive, and section 2041 is made, created, exercised, or relinquished for a consideration in money or money's worth, but is not a bona fide sale for an adequate and full consideration in money or money's worth, there shall be included in the gross estate *only* the excess of the fair market value at the time of death of the property otherwise to be included on account of such transaction, over the value of the consideration received therefor by the decedent.

The number that needs to be included in the gross estate can be expressed in an equation: $V_{included} = C_d + FMV_d - C_t$, where

$V_{included}$ = value that must be added to the gross estate;

C_d = date-of-death value of the consideration received by the decedent from the transaction that remains in his estate, see sec. 2033;

FMV_d = fair market value at date of death of property transferred by the decedent whose value is included in the gross estate under section 2036; and

C_t = consideration received by the decedent at the time of the transfer, which has to be subtracted under section 2043(a).

To see how this works, let's look at a few examples. We'll start with the simplest and work toward one that echoes what we have here.

Example 1: Constant Values. Imagine a parcel of land worth $1000. Its aging owner transfers its ownership to a FLP in which his partnership interest is worth $500, but he keeps a life estate. What's included in his gross estate is $1000, computed as the partnership interest valued at $500 when he died (and thus included in his estate under section 2033), plus $1000 (the value of the land as of the date of death), minus $500 (the value of the partnership interest when he received it). If the decedent hadn't done the transaction the $1000 parcel would be in his estate; the Code essentially nullifies the bargain sale's effect on the value of the gross estate.

This was more or less the situation in Estate of Powell. The result seems sensible. As we pointed out in that case, however, problems can arise when the value of the transferred asset fluctuates between the time of transfer and the time of death. Estate of Powell v. Commissioner, 148 T.C. at 408 n.7.

Let's turn to those.

Example 2: Inflating Values. Now consider the same facts as in the first example, but the value of the land and the FLP share doubles between the time of transfer and the date of death. The now $1000 FLP interest stays in the estate under section 2033; but one must add another $2000 to the estate because the fair market value of the land is also measured as of the date of death. The result is the inclusion of $2500 in the estate: $1000 + $2000 - $500. This might be thought to be less sensible: If the decedent had kept the land, only $2000 would be in his gross estate.

Example 3: Declining Values. Again, the same facts but the land and the FLP share halve in value. The FLP interest is worth only $250 at the date of death and the land is worth only $500. What's included in the gross estate? $250 + $500 - $500 = $250, instead of $500. This makes the decedent who does the transaction better off than one who doesn't.

And now we can introduce discounted FLP interests.

Example 4: Discounted Interest, But Simple. This example will have slightly different facts. There is still a piece of land worth $1,000 and the aging owner transfers it to a FLP. However, this time, the aging owner's son contributes a peppercorn to the FLP as well. Under the partnership agreement the son is the general partner and the aging land owner is the limited partner. Father and son agree that this triggers a 25% discount for lack of control, and the value of the father's partnership interest sinks to $750. Under the formula, the estate would include $750 for the FLP interest (under section 2033), $1000 for the transferred land (under section 2036), but with $750 subtracted (under section 2043).

Example 5: Discounted Interest, But Not Simple. Now assume the same facts as example 4 except this time the FLP sells the land for $1000. Then, the FLP makes a distribution of $400 back to the aging father. Under the formula this produces a strange result. Included in the estate is $400 cash (section 2033), $450 for the FLP interest (section 2033), $1000 for the transferred land (section 2036), less $750 (section 2043)--in all the estate now has a value of $1100. Had the aging man just sold the land he would have only $1000 in his estate.

Some of these examples thus lead to what may seem odd results, but we must nevertheless apply the Code as it is written and interpreted in a Division Opinion. See Sec. State Bank v. Commissioner, 111 T.C. 210, 213 (1998), aff'd, 214 F.3d 1254 (10th Cir. 2000); Hesselink v. Commissioner, 97 T.C. 94, 99-100 (1991); Nihiser v. Commissioner, T.C. Memo 2008-135, 95 T.C.M. (CCH) 1531, 1534 (2008).

And there's one last thing to note--the variable C_d is not limited by tracing rules. This means that whatever is left of the original consideration in an estate is included, but so are any proceeds from its later sale because section 2033 includes all property that a decedent owns in his gross estate. This also means that any property that leaves an estate after a transfer governed by section 2036 but before a decedent's death is *not* generally included in the gross estate.

ii. Application of Section 2043(a)

We can now begin to customize the equation to fit these cases. (We'll do this with verbal descriptions and leave the actual math to the parties under Rule 155.)

FMV_d. The fair market value of the farm was established by the sale to the Mellons. This was an arms-length sale to a third party, and neither the estate nor the Commissioner disputes that it sets the fair market value of the farm on both the date the price was agreed to and the date of sale. The transfer of four-fifths of the farm from the Living Trust to the FLP occurred at very nearly the same time as this sale. Moore then died less than two months later. We find it more likely than not that the fair market value of the farm did not change in so short a time. See, e.g., Cave Buttes, L.L.C. v. Commissioner, 147 T.C. 338, 355 (2016); Dunlap v. Commissioner, T.C. Memo 2012-126, 103 T.C.M. (CCH) 1689, 1709 (2012).

> C_t. Section 2043 tells us to subtract from this value of the farm the value of the consideration that Moore received. We value this consideration on the date it was received. One-fifth of the value of the farm went directly to the Living Trust and is a matter of multiplication. But what of the remaining four-fifths? This is the portion that went from the Living Trust to the FLP in exchange for an interest in the FLP. Here the parties' estimations diverge. The estate says that Moore got an interest in the FLP worth about $5.3 million; the Commissioner argues that it was worth about $8.5 million. Because of the brief time between the challenged transfer and Moore's death, we find it more likely than not that this value--whether it was $5.3 million or $8.5 million--did not change between the time Moore received it and the time he died. On the facts of these cases, then, we don't think this dispute matters because we would add back either figure after subtracting it.
>
> With the value of the consideration that Moore received measured at the time he received it equal to the value of the consideration that remained in his estate at the time of his death, the equation thus far is:
>
> (Either $5.3 million or $8.5 million + (.2 * value of farm at date of death)) + ((value of farm at date of death) - ((either $5.3 million or $8.5 million) + (.2 * value of farm at date of death))).
>
> C_d. This variable, however, is not simply the value of the consideration from the challenged transaction. Section 2033 tells us to include only the value of that consideration that remains in the estate as of the date of Moore's death. To get to this number we have to look for any money that left that estate after the farm's sale and before that date. There were three of these adjustments to the C_d variable that the parties identified and argued about:
>
> • unpaid attorney's fees,
>
> • transfers to Moore's children, and
>
> • $2 million dollar purported loan.

The upshot of the section 2043 analysis is that taxpayers need to avoid section 2036 if at all possible. Disposition of all interests in entities three years prior to death is helpful, as could be use of an incomplete gift trust to facilitate the gift or sale of non-voting units. The court concluded the transfers and loans were gifts.

The decedent's revocable trust had a charitable allocation clause to a CLAT that stated:

> [T]he smallest amount which, when transferred to the Howard V. Moore Charitable Lead Annuity Trust as provided in Section 2 of the Article will result in the least possible federal estate tax being payable as a result of my death after allowing for the applicable exclusion amount (after taking into account adjusted taxable gifts, if any) as finally determined for federal estate tax purposes, and the credit for state death taxes (but only to the extent that the use of this credit does not require an increase in the state death taxes paid).
>
> The denominator is the value of the Living Trust as determined for federal estate-tax purposes.

The court whiffed on its interpretation of that clause. First it found that it did not apply to zero-out the estate tax because the farm was not included in the trust so the clause could not direct it to charity. That is partially correct. Then it stated:

> There is also a second, much more general problem here. Charitable deductions are allowed only for the value of property in a decedent's gross estate if transferred to a charitable donee "by the decedent during his lifetime or by will." Sec. 20.2055-1(a), Estate Tax Regs. We have repeatedly denied charitable deductions where the donation turned upon the actions of the decedent's beneficiary or an estate's executor or administrator. See, e.g., Estate of Engelman v. Commissioner, 121 T.C. 54, 70-71 (2003); Estate of Marine v. Commissioner, 97 T.C. 368, 378-79 (1991), aff'd, 990 F.2d 136 (4th Cir. 1993).
>
> Charitable deductions must be ascertainable at a decedent's date of death. Ithaca Tr. Co. v. United States, 279 U.S. 151, 154 (1929)(transfers to a charity must be "fixed in fact and capable of being stated in definite terms of money"); Estate of Marine, 97 T.C. at 375. Section 20.2055-2(b)(1), Estate Tax Regs., states:
>
> If, as of the date of a decedent's death, a transfer for charitable purposes is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that the charitable transfer will not become effective is so remote as to be negligible.
>
> Whether the Living Trust would get additional funds from the Irrevocable Trust to transfer to the Charitable Trust was not ascertainable at Moore's death but only after an audit by the Commissioner, followed by a determination that additional property should be included in Moore's estate, followed by either the successful defense of that position or the estate's acquiescence to his determinations. For the exception to apply, it would have to have been almost certain that the Commissioner would not only challenge, but also successfully challenge the value of the estate. We do not think that's a reasonable conclusion.
>
> The estate likens its facts to those of Estate of Christiansen v. Commissioner, 586 F.3d 1061 (8th Cir. 2009), aff'g 130 T.C. 1 (2008), and Estate of Petter v. Commissioner, 653 F.3d 1012 (9th Cir. 2011), aff'g T.C. Memo. 2009-280. In Estate of Christiansen v. Commissioner, 586 F.3d at 1062-63, even though the amount of the property to be transferred was subject to change based on a formula clause, we allowed a charitable deduction because the transfer itself was not contingent on the happening of some event.
>
> In Estate of Petter, a FLP was to distribute LLC units to the trusts that Ms. Petter had set up for each of her children. The trusts were to receive a specific number of units up to a set dollar amount, with any units over that set value going to charity. Estate of Petter, 653 F.3d at 1020. Since the value of these units was unknown (because it was based on the FMV of stock held by the FLP), id., if a subsequent audit by the Commissioner led to a revaluation of the units then some of those units that had already been transferred to trusts had to be retransferred to the charitable donee in accordance with the trust provisions, id. at 1019. As in Estate of Christiansen, value was at issue, but not whether there would be a transfer to the donee at all. Estate of Petter, 653 F.3d at 1018.
>
> Article 5, section 2 of Moore's Irrevocable Trust does not say that the Living Trust will receive a transfer of assets of unknown value. It says that whether the Living

> Trust will even receive a transfer of assets is unknown-contingent on an examination by the Commissioner. This is unlike Estate of Christiansen, where we *knew* the charity would get a transfer of assets, just not the value, or Estate of Petter, where we *knew* the charity would get some transfer of value, just not how much. Here, we *don't know* if the charity would get any additional assets at all.

That is simply wrong. The allocation of assets between, say, a marital deduction and bypass trust works the same way as this clause. Judge Holmes also authored Christiansen and Petter. Why the different readings is unclear.

J. SECTIONS 2041 AND 2514 — GENERAL POWERS OF APPOINTMENT

1. Reformation of Trusts to Limit General Powers Allowed. In PLR 201920001 the IRS was presented with trusts that looked like generation–skipping trusts but which gave beneficiaries general powers where limited powers might have been expected. The problem was discovered after both spouses who were grantors had died. The parties had the trusts referenced in a state court action:

> The petition was supported by three affidavits, one each from Grantor's Accountant, Law Firm, and Son 1, in his capacity as the trustee of Trusts A and C and as representative by joinder of Trust B. Accountant swore that Grantor intended the trusts to be GST exempt. Law Firm swore that Grantor did not recognize that including the power of appointment language would result in including the trust assets in each Beneficiary's gross estate.
>
> On Date 4, Court issued an order, effective Date 1, that limited the power of appointment language in Article III(b)(2) to exclude the Beneficiary, the Beneficiary's estate, the creditors of the Beneficiary, and the creditors of the Beneficiary estate.
>
> On Date 5, Court issued an amended order clarifying that the trusts terminate at the death of the named grandchild and that per stirpes distributions are to be outright and in fee. The amended order clarifies that each separate trust held for a Beneficiary shall terminate upon the death of such Beneficiary. This is consistent with the provisions of each trust, as originally executed. Further, the amended order clarifies that each trust shall provide that upon such termination, the remaining principal and any undistributed income of such separate trust shall be distributed as such deceased Beneficiary may appoint to or for the benefit of one or more of the lineal descendants of the child of the Grantor (Son 1, Son 2, or Daughter, depending upon the trust) who is a lineal ascendant of such beneficiary, but excluding such Beneficiary, such Beneficiary's estate, the creditors of such Beneficiary, and the creditors of such Beneficiary's estate. The default provisions of each trust remain unchanged. Both orders were issued contingent upon a ruling from the Internal Revenue Service.

The IRS ruled:

> In the present case, an examination of the relevant trust instruments, affidavits, and representations of the parties strongly indicates that Grantor and Spouse did not intend for the Beneficiaries of Trusts A, B, and C to have inter vivos or testamentary general powers of appointment. In reforming the trusts, Court found that there was clear and convincing evidence that the language in Article III(b)(2) and Article III(c) were scrivener's errors and that the reformation and modification of the trusts was necessary and appropriate to achieve Grantor's and Spouse's

> objectives, and that the reformation was not contrary to Grantor's and Spouse's intentions.
>
> Consequently, based on the facts submitted and representations made, we conclude that the Court's Orders of Date 4, Date 5, and Date 7, reforming and modifying the trust instruments based on scrivener's errors, are consistent with applicable State law that would be applied by the highest court of that state. Trusts A, B, and C, as reformed and modified pursuant to the Court's Orders, do not provide the Beneficiaries with either inter vivos or testamentary general powers of appointment over the assets of each respective Beneficiary's trust under §§ 2041(b) and 2514(c). Accordingly, based on the facts submitted and the representations made, we conclude that the judicial reformation and modification of Trusts A, B, and C do not constitute the exercise or release of a general power of appointment by a Beneficiary resulting in a gift under § 2514 and that the assets of the deceased Beneficiary's trust will not be includible in such Beneficiary's gross estate under § 2041.

2. **<u>Power to Create or Eliminate General Powers of Appointment Allowed</u>**. In PLR 201845006 the IRS was asked if the amendment of a trust would have any transfer tax consequences. The ruling summarizes the most interesting question as follows:

> In this case, Son and Child 1 have beneficial interests in Trust and are the current Co-Trustees. Section 3.09 grants to a non-beneficiary trustee certain trustee powers, including the power to limit or eliminate Son's testamentary general power of appointment under Section 2.013. Prior to the modification, the terms of Trust did not provide a method for appointing a non-beneficiary trustee who may exercise the powers in Section 3.09 granted to only non-beneficiary trustees. The modification of Trust to add Section 8.06 to provide a method for appointing an independent special trustee who may exercise the powers set forth in Section 3.09, and to appoint Bank 2 as an independent special trustee with the authority to exercise the powers set forth in Section 3.09 of Trust, does not change or transfer the interests of Son during his lifetime, nor does it confer any new rights to any beneficiaries. Rather, the modification provides a process for the powers set forth in Section 3.09 to be administered by a non-beneficiary trustee (i.e., Special Trustee). The testamentary power of appointment granted to Son in Section 2.013 occurs upon the death of Son, and is not currently exercisable by Son. Son retains the same interest in Trust, both before and after the modification.

The IRS held:

> Accordingly, based on the facts submitted and the representations made, we conclude that Bank 2's acceptance and appointment to the office of Special Trustee of Trust pursuant to the Order will not constitute the exercise or release of a general power of appointment under § 2514 so as to constitute a gift by Son for federal gift tax purposes. Further, we conclude that the exercise of trustee powers, including those delineated in Sections 3.092 and 3.093 of Trust by Bank 2, or a successor Special Trustee, to limit or eliminate Son's testamentary general power of appointment granted under Section 2.013 of Trust will not constitute the exercise or release of a general power of appointment under § 2041(a)(2), and, as a result, the Trust assets will not be included in Son's gross estate under § 2041(a)(2).

3. **<u>Effect of Change of State Law on General Power in Trustee</u>**. A decedent was sole trustee and a beneficiary in PLR 202020008, with discretion to distribute assets as follows:

> Article Sixth of Mother's will and Article Seventh of Father's will provide that if the trustee deems the net income of the respective trusts not sufficient to provide for the proper support, maintenance, comfort, education and recreation of any income beneficiary, taking into consideration other income and financial resources of such beneficiary, so far as known to the trustee, the trustee may as often as it deems necessary pay to or apply for the use and benefit of such beneficiary such additional part of the corpus of the trust estate (including the whole thereof) as the trustee in its sole and absolute discretion believes will be in the best interest of and tend to promote the welfare of such beneficiary.

No governing law for the trust was specified and the decedent/trustee moved from one state to another. The IRS notes the applicable state law:

> In Year 1, while Decedent was residing in State A, State A enacted Statute 1, which provides in part that unless a settlor or a testator clearly indicates that a broader power is intended by express reference to Statute 1, a person who is a beneficiary of a trust that permits the person, as trustee or co-trustee, to make discretionary distributions of income or principal to or for the benefit of himself or herself may exercise that power in his or her favor only for his or her health, education, support, or maintenance within the meaning of § 2041 and § 2514 of the Internal Revenue Code (Code). Statute 1 applies to any irrevocable trust created under a document executed in or before Year 1, unless all parties in interest elect affirmatively not to be subject to the provision. Such election was not made with respect to Trust 1 and Trust 2.
>
> In Year 2, Decedent became a resident of State B and remained a State B resident until his death on Date 3. Statute 2, effective in State B at the time of Decedent's death, provides in part that unless the terms of the trust expressly indicate that Statute 2 does not apply, a person who is a beneficiary and a trustee may not make discretionary distributions of either principal or income to or for the benefit of that trustee, except to provide for that trustee's health, education, maintenance, or support as described under § 2041 and § 2514 of the Code.

The IRS concluded that the decedent did not have a general power nor did the enactment of the statute in State A or the move to State B affect the GST grandfathered status of the trusts:

> In Ruling 1 of the present case, we conclude that the enactment of Statute 1 did not constitute a release of a general power of appointment by Decedent. In Ruling 2 of the present case, we conclude that Decedent did not have a general power of appointment at the time of his death and that the lapse of Decedent's fiduciary powers as trustee at his death did not constitute a release of a general power of appointment. Therefore, we conclude neither the enactment of Statute 1 nor the lapse of Decedent's fiduciary powers at his death constitute a constructive addition to the trust for purposes of § 26.2601-1(b)(1)(v)(A).
>
> The enactment of Statute 1 did not change the standard for which distributions can be made to Decedent under the terms of Trust 1 or Trust 2. The enactment of Statute 1 changed who may exercise certain fiduciary powers. Any successor trustee or co-trustee of Trust 1 or Trust 2 appointed pursuant to Article Eighth of Mother's will or Article Ninth of Father's will would have had the power to make

> the broader distributions to Decedent from Trust 1 and Trust 2 as are allowable under Article Sixth of Mother's will and Article Seventh of Father's will, respectively. The state law restriction on Decedent's ability to exercise the fiduciary powers himself, as trustee of Trust 1 and Trust 2, does not change his interest in the trust for the purposes of § 26.2601-1(b)(4)(i)(D)(2).
>
> In the present case, we conclude that the enactment of Statute 1 will not be considered a modification or trustee action that: (1) results in a shift of a beneficial interest in Trust 1 or Trust 2 to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the modification; or (2) extends the time for vesting of any beneficial interest in Trust 1 or Trust 2 beyond the period provided for in the original trust terms. Accordingly, we conclude that the enactment of Statute 1 did not affect the exempt status of Trust 1 or Trust 2. Additionally, we conclude that because Statute 2 imposes substantially the same changes as Statute 1, Decedent becoming a resident of State B and becoming subject to Statute 2 did not affect the exempt status of Trust 1 or Trust 2.

The ruling is one of a series.

K. SECTIONS 61, 83, 409A, 2042 AND 7872 - LIFE INSURANCE

L. SECTION 2053 and 2054 - DEBTS AND ADMINISTRATION EXPENSES

M. SECTIONS 2056, 2056A AND 2519- MARITAL DEDUCTION

1. **Marital Deduction and Phantom Assets**. In Estate of Clyde W. Turner, Sr. et al. v. Commissioner, T.C. Memo. 2011-209, Judge Marvel found that section 2036 applied to an investment partnership created by Clyde W. Turner, Sr. and his wife, Jewell. The first issue was whether funding the partnership was a bona fide sale. The opinion states:

> Petitioner argues that Clyde Sr. and Jewell created Turner & Co. for at least one of the following legitimate and significant nontax reasons:
>
> > (1) To consolidate their assets for management purposes and allow someone other than themselves or their children to maintain and manage the family's assets for future growth pursuant to more active and formal investment management strategy; (2) to facilitate resolution of family disputes through equal sharing of information; and (3) to protect the family assets and Jewell from Rory, and protect Rory from himself.
>
> The objective facts in the record fail to establish that any of these reasons was a legitimate and significant reason for formation of Turner & Co.
>
> * * *
>
> In reaching our conclusion that asset management was not a significant nontax purpose, we rely on our finding that Turner & Co.'s portfolio of marketable securities did not change in a meaningful way. Regents Bank stock continued to dominate the portfolio from the time of the partnership formation until Clyde Sr.'s death. Whatever assets Turner & Co. added to the portfolio had a risk/return profile similar to the profile of the assets Clyde Sr. and Jewell contributed to the partnership. For example, the account statements for Turner & Co.'s Wachovia Securities account reflect only four purchases up to the date of Clyde Sr.'s death:

> GMAC Notes, Morgan Stanley preferred stock, Ford Motor preferred stock, and Suburban Propane Partners common stock. The account statements of Turner & Co.'s Morgan Keegan accounts also show only a few purchases. According to those statements, Turner & Co. purchased Ford Motor Credit preferred stock (three purchases), GMAC Notes, GMAC Smart Notes, and General Electric notes. With the exception of common stock of Suburban Propane Partners, Turner & Co. therefore generally added to its portfolio fixed-income investments. Turner & Co. therefore continued to hold a portfolio consisting of common stock of mostly bank companies, preferred stock, bonds, cash, and cash equivalents, similar to what Clyde Sr. and Jewell held individually. As a consequence, handing management over the assets to Marc and Turner had no material impact on the profit potential of the portfolio.
>
> Petitioner points to the fact that Turner & Co. opened and closed certificates of deposit at various banks to support petitioner's claim of active investing. Yet certificates of deposit are akin to cash equivalents, and renewing certificates of deposit can hardly be considered pursuing a diversified strategy. The objective facts in the record do not support petitioner's argument that Turner & Co. was formed to consolidate Clyde Sr. and Jewell's assets and allow for centralized management pursuant to a formal investment strategy or to pursue a more aggressive investment strategy.

In addition, the Court dealt with whether certain indirect gifts of life insurance premiums, paid directly by Clyde, Sr., when the insurance was owned by a trust, were present interests. The court concluded that they were:

> The parties agree that Clyde Sr. made indirect gifts to the beneficiaries of Clyde Sr.'s Trust when he paid the premiums on life insurance policies for the benefit of his children and grandchildren. The parties disagree, however, on the nature of the gifts. Petitioner contends that the gifts were gifts of present interests (and therefore subject to the annual exclusion) because the beneficiaries had the absolute right and power to demand withdrawals of amounts transferred to Clyde Sr.'s Trust. Respondent contends that the gifts were gifts of future interests (and therefore not subject to the annual exclusion). Specifically, respondent argues the beneficiaries' withdrawal rights were illusory because Clyde Sr. did not deposit money with the trustees of Clyde Sr.'s Trust but instead paid the life insurance premiums directly and because the beneficiaries did not receive notice of the transfers. Consequently, respondent argues that the beneficiaries had no meaningful opportunity to exercise the right of withdrawal.
>
> The terms of Clyde Sr.'s Trust gave each of the beneficiaries the absolute right and power to demand withdrawals from the trust after each direct or indirect transfer to the trust. The fact that Clyde Sr. did not transfer money directly to Clyde Sr.'s Trust is therefore irrelevant. Likewise, the fact that some or even all of the beneficiaries may not have known they had the right to demand withdrawals from the trust does not affect their legal right to do so. See Crummey v. Commissioner, supra at 86-87; Estate of Cristofani v. Commissioner, supra at 80. We therefore conclude that the premium payments Clyde Sr. made as indirect gifts to Clyde Sr.'s Trust in 2000-2003 were gifts of present interests and are subject to the annual exclusion.
>
> Respondent argues, in the alternative, that even if we conclude the premium payments were gifts of present interests, some of the gifts made in 2002 and 2003 -- specifically, the gifts made to Clyde Jr., Betty, Janna, Trey, and Rory -- are still includable in Clyde Sr.'s taxable estate. This is so, respondent argues, because the transfers of limited partnership interests to Clyde Jr., Betty, Janna, Trey, and Rory

> in 2002 and 2003 used up their annual exclusions and any additional gifts to those beneficiaries during 2002 and 2003 are includable in Clyde Sr.'s estate. We disagree.
>
> For the reasons discussed above, we have concluded that the value of property Clyde Sr. transferred to Turner & Co. is included in his gross estate under section 2036. Consequently, the gifts of limited partnership interests that the estate reported on Forms 706 and 709 must be disregarded for purposes of calculating Clyde Sr.'s adjusted taxable gifts. To do otherwise would result in the double inclusion of a significant part of the property transferred to Turner & Co. in Clyde Sr.'s estate.

In Estate of Clyde W. Turner, Sr., et al. v. Commissioner, 138 T.C. No. 14; 18911-08, the Tax Court affirmed its decision to include assets in the decedent's family limited partnership in the decedent's estate via section 2036, and denied a marital deduction for the "phantom assets" so included:

> If we were to accept the estate's position, Jewell's estate would not be required to include in the gross estate the values of assets that Jewell did not actually own but with respect to which a marital deduction was allowed to Clyde Sr.'s estate. There is no Code provision similar to sections 2044 and 2519 that would require adding such assets into her transfer tax base. The lack of such a provision would allow the assets to leave Clyde Sr. and Jewell's marital unit without being taxed, thereby frustrating the purpose and the policy underlying the marital deduction. Although the formula of Clyde Sr.'s will directs what assets should pass to the surviving spouse, the assets attributable to the transferred partnership interest or the partnership interest itself are not available to fund the marital bequest; their disposition to the donees occurred during Clyde Sr.'s lifetime but is deemed delayed until Clyde Sr.'s death by our holding that section 2036 applies. Because the property in question did not pass to Jewell as beneficial owner, we reject the estate's position and hold that the estate may not rely on the formula of Clyde Sr.'s will to increase the marital deduction.

In what can be referred to as Turner III, 151 T.C. No. 10 (2018), the issue was whether the estate must reduce the marital deduction by the amount of estate tax generated by the inclusion of the "phantom" assets under section 2036. The Tax Court held that no reduction was warranted because of the estate's right of reimbursement. The opinion states:

> Under section 2036 the gross estate includes the values of the section 2036 assets that Clyde Sr. transferred during his lifetime. The fact that property that might otherwise go to the surviving spouse would be used to pay the estate tax liabilities attributable to the section 2036 assets does not compel a conclusion that the marital deduction must be reduced. The estate is entitled to recover from the recipients of section 2036 assets during Clyde Sr.'s lifetime an amount equal to the liability attributable to the section 2036 inclusion that the estate pays. That recovery will enable the estate to distribute to the surviving spouse property value undiminished by the tax payments. Section 20.2056(b)-4(c), Estate Tax Regs., does not require a different result when the Federal estate and State death taxes have no effect upon the net value distributable to the surviving spouse. See, e.g., Estate of Gill v. Commissioner, T.C. Memo. 2012-7 (marital deduction not reduced where marital deduction property does not bear the economic burden of the tax). Accordingly, we hold that the estate need not reduce the marital deduction by the amount of Federal estate and State death taxes it must pay

> because the tax liabilities are attributable to the section 2036 assets, the estate has the right to recover the amount paid under section 2207B, and the estate must exercise that right to recover to give effect to Clyde Sr.'s intention that Jewell receive her share of the estate undiminished by the estate's tax obligations.

What of the argument that the estate might not seek reimbursement? The opinion concludes that won't happen.

> Section 2207B is one of several Code sections that provide for a right of recovery for certain types of property or dispositions. 8 Unless the will of a Georgia decedent expressly directs otherwise, Georgia law does not limit any rights to reimbursement for Federal estate taxes and other taxes that may be available to the executor under Federal law. See Ga. Code Ann. sec. 53-4-63(e).
>
> As discussed above, Clyde Sr.'s will does not address the payment of taxes or their apportionment, nor does it express any intent regarding the right of recovery under section 2207B or any other right of recovery provision. This is not surprising because Clyde Sr. did not know that the Court would apply section 2036 to his lifetime transfers. Item Eight of Clyde Sr.'s will, however, clearly manifests his intention that the marital deduction not be reduced or diminished by the estate's tax liabilities. It is reasonable to assume that Clyde Sr. would want his executor to take all steps necessary to ensure that the property passing to his surviving spouse and qualifying for the marital deduction not be impaired
>
> Respondent argues that the right of recovery under section 2207B cannot preserve the maximum marital deduction because the right of recovery can be exercised only after taxes have been paid. However, the fact that the estate may exercise the right of recovery under section 2207B only after the taxes have been paid does not require that the marital deduction be reduced by the tax payment amounts.

The court recognizes the issue and states in footnote 9:

> The parties do not address Estate of Wycoff v. Commissioner, 506 F.2d 1144 (10th Cir. 1974), aff'g 59 T.C. 617 (1973), but we find it appropriate to distinguish this case. In Estate of Wycoff v. Commissioner, 506 F.2d at 1146, the decedent's will created two trusts, one in favor of his wife and the other for the benefit of his son. The decedent directed that Federal estate and State death taxes be paid out of the portion of his estate that was not in the marital trust; but at the same time, he granted the executor discretion to pay these taxes out of the marital trust if the executor considered it prudent to do so. The U.S. Court of Appeals for the Tenth Circuit reasoned that although the will expressed a preference for payment from the part of the estate not included in the marital trust, the will contained no positive direction that Federal estate and State death taxes be paid from the part of the estate not included in the marital share. Id. at 1150. The Court of Appeals stated: "[A]s we view it such an express provision would be necessary to justify a ruling for the executor" and held that "§ 2056(b)(4) renders the marital share available to the surviving spouse subject to the payment of death taxes." Id. As a result, the Court of Appeals held that the value of the marital deduction had to be reduced by the amount of the applicable taxes.
>
> Estate of Wycoff is distinguishable because the executor of the estate could choose from which trust to pay the expenses. In this case, however, Clyde Sr.'s will is silent as to the payment of taxes, and we have found that Clyde Sr. wanted

> to maximize the marital deduction and that the executor must exercise the right of recovery under sec. 2207B.

A marital deduction for income earned during the estate was not allowed.

N. SECTIONS 2501 TO 2524 – GIFTS

1. Unusual Assignment Clause Produced A Gift. Nelson v. Commissioner, T.C. Memo. 2020-81, involved the transfer of units in a limited partnership, Longspar, to a trust in 2008. One transfer was a gift, the other a sale for a note. The transfers were by assignment as follows:

> Mrs. Nelson made two transfers of limited partner interests in Longspar to the Trust. The first transfer was a gift on December 31, 2008. The Memorandum of Gift and Assignment of Limited Partner Interest (memorandum of gift) provides:
>
>> [Mrs. Nelson] desires to make a gift and to assign to * * * [the Trust] her right, title, and interest in a limited partner interest having a fair market value of TWO MILLION NINETY-SIX THOUSAND AND NO/100THS DOLLARS ($2,096,000.00) as of December 31, 2008 * * *, as determined by a qualified appraiser within ninety (90) days of the effective date of this Assignment.
>
> Petitioners structured the second transfer, on January 2, 2009, as a sale. The Memorandum of Sale and Assignment of Limited Partner Interest (memorandum of sale) provides:
>
>> [Mrs. Nelson] desires to sell and assign to * * * [the Trust] her right, title, and interest in a limited partner interest having a fair market value of TWENTY MILLION AND NO/100THS DOLLARS ($20,000,000.00) as of January 2, 2009 * * *, as determined by a qualified appraiser within one hundred eighty (180) days of the effective date of this Assignment * * *.
>
> Neither the memorandum of gift nor the memorandum of sale (collectively transfer instruments) contains clauses defining fair market value or subjecting the limited partner interests to reallocation after the valuation date. In connection with the second transfer, the Trust executed a promissory note for $20 million (note). Mr. Nelson, as trustee, signed the note on behalf of the Trust. The note provides for 2.06% interest on unpaid principal and 10% interest on matured, unpaid amounts, compounded annually, and is secured by the limited partner interest that was sold. Annual interest payments on the note were due to Mrs. Nelson trough the end of 2017.

Appraisals were completed and 6.14% and 58.65% of the Longspar units were transferred. Upon audit, the IRS increased the values of the units transferred. The question for the court was what was transferred:

> The parties agree that the transfers were complete once Mrs. Nelson executed the transfer instruments parting with dominion and control over the interests. See Burnet v. Guggenheim, 288 U.S. 280, 286 (1933); Carrington v. Commissioner, 476 F.2d 704 (5th Cir. 1973), aff'g T.C. Memo. 1971-222; Estate of Metzger v. Commissioner, 100 T.C. 204, 208 (1993), aff'd, 38 F.3d 118 (4th Cir. 1994); sec. 25.2511-2(b), Gift Tax Regs. But they disagree over whether Mrs. Nelson

transferred Longspar limited partner interests of $2,096,000 and $20 million, as petitioners contend, or percentage interests of 6.14% and 58.65%, as respondent contends.

We look to the transfer documents rather than subsequent events to decide the amount of property given away by a taxpayer in a completed gift. See Estate of Petter v. Commissioner, T.C. Memo. 2009-280, 2009 WL 4598137, at *12 (citing Succession of McCord v. Commissioner, 461 F.3d 614, 627 (5th Cir. 2006), rev'g and remanding 120 T.C. 358 (2003)), aff'd, 653 F.3d 1012 (9th Cir. 2011); see also Commissioner v. Procter, 142 F.2d 824 (4th Cir. 1944) (disregarding the subsequent reallocation of property to the donor via a saving clause as contrary to public policy), rev'g and remanding a Memorandum Opinion of this Court. Petitioners argue that the transfer instruments show that Mrs. Nelson transferred specific dollar amounts, not fixed percentages, citing a series of cases that have respected formula clauses as transferring fixed dollar amounts of ownership interests. In each of those cases we respected the terms of the formula, even though the percentage amount was not known until fair market value was subsequently determined, because the dollar amount was known. Wandry v. Commissioner, T.C. Memo. 2012-88, 2012 WL 998483, at *4; Hendrix v. Commissioner, T.C. Memo. 2011-133, 2011 WL 2457401, at *5-*9; Estate of Petter v. Commissioner, 2009 WL 4598137, at *11-*16.

Saving clauses have been treated differently. As we explained in Estate of Petter and Wandry, courts have rejected saving clauses because they relied on conditions subsequent to adjust the gifts or transfers so the size of the transfer (as measured either in dollar amount or percentage) could not be known. Thus, for example, in Commissioner v. Procter, 142 F.2d at 827, the Court of Appeals for the Fourth Circuit rejected a clause adjusting part of a gift to "automatically be deemed not to be included in the conveyance in trust hereunder and shall remain the sole property of * * * [the taxpayer]" because the adjustment would be triggered only by a "final judgment or order of a competent federal court of last resort that any part of the transfer * * * is subject to gift tax."

In Succession of McCord v. Commissioner, 461 F.3d at 618, the Court of Appeals for the Fifth Circuit upheld a gift of an interest in a partnership expressed as "a dollar amount of fair market value in interest" reduced by a transfer tax obligation rather than a percentage interest that was determined in agreements subsequent to the gift. It held that "a gift is valued as of the date that it is complete; the flip side of that maxim is that subsequent occurrences are off limits." Id. at 626. The formula clause in the initial transfer document did not include qualifying language that fair market value was to be "as finally determined for [Federal gift] tax purposes," but the court did not find that omission fatal because the value of the gift was ascertainable as of the date it was complete. Id. at 627.

Petitioners argue that we should construe the transfer clauses here as more akin to the formula clauses that were upheld in Succession of McCord, Estate of Petter, and Wandry, that is, read them as transferring dollar amounts rather than percentages. However, as part of their argument, they cite evidence of their intent, which includes their settlement discussions with IRS Appeals and subsequent adjustments to reflect changes in valuation to reflect those discussions. Of course, as in Succession of McCord, we look to the terms of the transfer instruments and not to the parties' later actions except to the extent that we conclude the terms are ambiguous and their actions reveal their understanding of those terms. Id. at 627-628.

> Therefore, to decide whether the transfers were of fixed dollar amounts or fixed percentages, we start with the clauses themselves, rather than the parties' subsequent actions. The gift is expressed in the memorandum of gift as a "limited partner interest having a fair market value of TWO MILLION NINETY-SIX THOUSAND AND NO/100THS DOLLARS ($2,096,000.00) as of December 31, 2008 * * *, as determined by a qualified appraiser within ninety (90) days of the effective date of this Assignment." Similarly, the sale is expressed in the memorandum of sale as a "limited partner interest having a fair market value of TWENTY MILLION AND NO/100THS DOLLARS ($20,000,000.00) as of January 2, 2009 * * *, as determined by a qualified appraiser within one hundred eighty (180) days of the effective date of this Assignment."
>
> The transferred interests thus are expressed in the transfer instruments as an interest having a fair market value of a specified amount as determined by an appraiser within a fixed period. The clauses hang on the determination by an appraiser within a fixed period; value is not qualified further, for example, as that determined for Federal estate tax purposes. See, e.g., Estate of Christiansen v. Commissioner, 130 T.C. 1, 14-18 (2008) (upholding gift clause providing fair market value "as such value is finally determined for federal estate tax purposes"), aff'd, 586 F.3d 1061 (8th Cir. 2009); Estate of Petter v. Commissioner, 2009 WL 4598137, at *11-*16 (upholding gift clause transferring the number of units of a limited liability company "that equals one-half the minimum * * * dollar amount that can pass free of federal gift tax by reason of Transferor's applicable exclusion amount" along with a clause providing for an adjustment to the number of units if the value "is finally determined for federal gift tax purposes to exceed the amount described" in the first clause).
>
> Unlike the clause in Succession of McCord, "fair market value" here already is expressly qualified. By urging us to interpret the operative terms in the transfer instruments as transferring dollar values of the limited partner interests on the bases of fair market value as later determined for Federal gift and estate tax purposes, petitioners ask us, in effect, to ignore "qualified appraiser * * * [here, Mr. Shrode] within * * * [a fixed period]" and replace it with "for federal gift and estate tax purposes." While they may have intended this, they did not write this. They are bound by what they wrote at the time. As the texts of the clauses required the determination of an appraiser within a fixed period to ascertain the interests being transferred, we conclude that Mrs. Nelson transferred 6.14% and 58.35% of limited partner interests in Longspar to the Trust as was determined by Mr. Shrode within a fixed period.

Longspar itself owned interests in a closely-held company, "Stacked" discounts were allowed, summarized by the court as follows:

> First, Mrs. Nelson transferred 6.14% and 58.65% Longspar limited partner interests to the Trust. Next, discounts of 15% for lack of control and 30% for lack of marketability should apply to the valuation of WEC common stock, resulting in a fair market value of $912 per share. Therefore, the controlling, marketable value of Longspar is $60,729,361. Discounts of 5% for lack of control and 28% for lack of marketability should apply to calculate the fair market value of a Longspar limited partnership interest. As a result, a 1% Longspar limited partner interest has a fair market value of $411,235 and the 6.14% and 58.65% Longspar limited partner interests Mrs. Nelson transferred to the Trust have fair market values of $2,524,983 and $24,118,933, respectively.

2. Gifts vs. Loans vs. Loans Incapable of Repayment. At issue in Estate of Bolles, T.C. Memo. 2020-71, was whether various transfers, mother to son, were gifts, loans, or, as it turns out, loans that couldn't be repaid. The court's conclusion is as follows:

> Finally, we address the issue of whether the advances were loans or gifts. Both parties rely on the analysis of Miller v. Commissioner, T.C. Memo. 1996-3, aff'd, 113 F.3d 1241 (9th Cir. 1997), for the traditional factors used to decide whether an advance is a loan or a gift. Those factors are explained as follows: (1) there was a promissory note or other evidence of indebtedness, (2) interest was charged, (3) there was security or collateral, (4) there was a fixed maturity date, (5) a demand for repayment was made, (6) actual repayment was made, (7) the transferee had the ability to repay, (8) records maintained by the transferor and/or the transferee reflect the transaction as a loan, and (9) the manner in which the transaction was reported for Federal tax purposes is consistent with a loan.
>
> These factors are not exclusive. See, e.g., Estate of Maxwell v. Commissioner, 98 T.C. 594 (1992), aff'd, 3 F.3d 591 (2d Cir. 1993). In the case of a family loan, it is a longstanding principle that an actual expectation of repayment and an intent to enforce the debt are critical to sustaining the tax characterization of the transaction as a loan. Estate of Van Anda v. Commissioner, 12 T.C. 1158, 1162 (1949), aff'd per curiam, 192 F.2d 391 (2d Cir. 1951).
>
> While Mary recorded the advances to Peter as loans and kept track of interest, there were no loan agreements or attempts to force repayment. Respondent focuses on the lack of security for the loans to Peter. We agree that the reasonable possibility of repayment is an objective measure of Mary's intent. The estate maintains that during her life Mary always considered these advances as loans. We cannot reconcile this argument with the deterioration of Peter's financial situation and the ultimate failure of his practice in San Francisco and later in Las Vegas.
>
> Peter's creativity as an architect and his ability to attract clients likely impressed Mary. We find she expected him to make a success of the practice as his father had, and she was slow to lose that expectation. However, it is clear she realized he was very unlikely to repay her loans by October 27, 1989, when her trust provided for a specific block of Peter's receipt of assets at the time of her death. Accordingly, in 1990 the "loans" lost that characterization for tax purposes and became advances on Peter's inheritance from Mary. In conclusion, we find the advances to Peter were loans through 1989 but after that were gifts. We have considered whether she forgave any of the prior loans in 1989, but we find that she did not forgive the loans but rather accepted they could not be repaid on the basis of Peter's financial distress.

For the opinion to be helpful requires close attention to the facts:

> A loving mother of her five children, Mary was determined to provide her assets to her children equally. Her practice was to keep a personal record of her advances and occasional repayments for each child. On the basis of her original intent and the advice of her tax counsel, she treated the advances as loans. She forgave the "debt" account of each child every year on the basis of the gift tax exemption amount. Her practice would have been noncontroversial but for the substantial funds she advanced to Peter.
>
> ***
>
> Peter was the oldest of their five children. He graduated from college with a degree in architecture in 1965. On the basis of his academic achievements and his father's reputation as an architect in San Francisco, Peter's professional career showed great promise. He began his career in Boston. He took over his father's architecture practice in San Francisco in the early 1970s and enjoyed some early success in attracting clients. Peter expanded the practice through the 1970s into the early 1980s; but despite his salesmanship he began to have financial difficulties largely because his expectations exceeded realistic results. By 1983 Peter's practice was not current on its bills. In July 1983 Peter, as president of Bolles Associates and Peter B. Bolles, P.A., entered into an agreement with the Bolles Trust to use trust property as security for $600,000 in bank loans. The agreement also reflects that the Bolles Trust was owed $159,828 in back rent by Peter's practice. Within a year Peter had failed to meet the obligations of the agreement, and the Trust was ultimately held liable for the $600,000. Mary had contemporaneous knowledge of these events.

Between 1985 and 2007 Mary transferred $1,063,333 to or for Peter's benefit (directly to him, to his accounts, paying other of his debts). Peter made no payments after 1988. In Mary's estate plan, she adjusted for the transfers, with interest (using the AFR). The IRS argument was that either Mary made gifts or a note should be in her estate:

> The calculations found in article five of the First Amendment describe the manner in which advances, described as loans, are to be taken into account in dividing the trust assets among decedent's children upon her death. In essence, under subparagraph (b), the value of the trust assets after allowance for expenses such as estate tax is divided equally; however, each child's share is reduced, and that amount redistributed pro rata among the other beneficiaries, by the amount of the child's outstanding loans, if any, plus accrued interest.
>
> > The explanation of adjustments to the notice of deficiency states:
> >
> > I. Schedule C, Items 2 and 3
> >
> > It is determined that the fair market value of the Promissory Note and receivable due from Peter P. Bolles under IRC section 2031 is $1,063,333 instead of zero as reported and that interest on the Promissory Note and receivable is includible in the gross estate under IRC section 2033 in the amount of $1,165,778. Therefore, the value of the gross estate is increased by $2,229,111.

II. Adjusted Taxable Gifts

In the event it is determined that the fair market value under IRC section 2031 of the Promissory Note and receivable from Peter Bolles and interest on the Promissory Note and receivables is zero then it is determined that Mary P. Bolles transferred property to Peter Bolles during her life such that "adjusted taxable gifts" in the amount of $1,063,333 is included in computing taxpayer's estate tax liability under IRC section 2001(b).

O. SECTION 2518 – DISCLAIMERS

P. SECTIONS 2601-2654 - GENERATION-SKIPPING TRANSFER TAX

1. Substantial Compliance For Timely Allocation. In PLR 201936001 the taxpayer elected out of the automatic allocation rules, allocated exemption anyway, but failed to attach a Notice of Allocation. The IRS said the allocation was timely due to substantial compliance:

> In this case, Taxpayer elected out of the automatic allocation rules with respect to the transfer to Trust on a timely filed Form 709. Nonetheless, Taxpayer could still allocate GST exemption to the transfer by properly reporting the allocation on a timely filed Form 709. Taxpayer properly reported the allocation of GST exemption on Schedule C, Part 2, Line 6. However, Taxpayer failed to attach a Notice of Allocation with the Form 709. The information on the Form 709, in combination with the terms of Trust (a copy of which was attached to the return), demonstrates Taxpayer's intent to allocate $aa of his GST exemption to Trust and provides sufficient information to constitute substantial compliance under § 2642(g)(2).

2. Modification of GST Grandfathered Trust Allowed Where Property Vested in Same Generation As Before Modification. PLR 202011001 states:

> In this case, Trust A was irrevocable prior to September 25, 1985. The amended trust agreement provides for outright distribution to the beneficiaries upon the termination of Trust A and the Trust A Successor Trusts, 21 years after the death of Son. Under the proposed modification of the trust agreement, any share upon the termination of Trust A and the Trust A Successor Trusts distributable to a beneficiary who is under the age of b, will be held in a continuing trust for that continuing beneficiary. Each continuing beneficiary will have a testamentary general power of appointment with respect to the property. Under § 2041(a)(2), the continuing beneficiary's trust property will be includible in his or her estate at his or her death. Further, each continuing beneficiary will be treated as the transferor of the trust corpus for GST tax purposes under § 2652(a)(1). The proposed modification will not result in a shift of any beneficial interest in any beneficiary who occupies a generation lower than the persons holding the beneficial interests. Further, the proposed modification in further trust will not extend the time for vesting of any beneficial interest in any trust. Accordingly, based on the facts presented and the representations made, we rule that the proposed modification will not cause Trust A or the Trust A Successor Trusts to lose their exemption from the GST tax of chapter 13.

The modifications appeared to have the purpose of affecting distribution to son. The ruling is one of a series.

3. **Reformation Allowed Where Right To Withdraw Not Limited to 5 x 5**. PLR 201941008 states:

> The withdrawal provision in Paragraph 7.02 contains a drafting error. Each Primary Beneficiary's withdrawal right over the assets contributed to a Child's Trust in any given year is not limited to the greater of $5,000 or 5 percent of the value of the trust assets. Accordingly, any lapse of a Primary Beneficiary's withdrawal right would be treated as a taxable transfer by that Primary Beneficiary under § 2514 to the extent that the property that could have been withdrawn exceeds in value the greater of $5,000 or 5 percent of the aggregate value of the assets subject to withdrawal. Moreover, each Primary Beneficiary would become a transferor to his or her Child's Trust for GST tax purposes with respect to the portion of the Child's Trust constituting a gift by the Child, thereby preventing (i) an effective deemed allocation of GST exemption under § 2632(c) by Settlor and Spouse with respect to Settlor's transfers to that Child's Trust for each of Year 1, Year 2, Year 3, and Year 4; and (ii) an effective deemed allocation of GST exemption under § 2632(b) by Grandfather and Grandmother with respect to Grandfather's transfer to that Child's Trust for each of Year 1 and Year 2. In addition, the portion of each Child's Trust relating to the lapsed withdrawal right in excess of $5,000 or 5 percent of the value of the trust assets would be included in the Primary Beneficiary's gross estate for estate tax purposes.
>
> The error was discovered when Settlor engaged new estate planning counsel who reviewed Settlor's current estate plan, including Trust. Settlor was informed of the drafting error that defeated the intent of the Settlor in establishing Trust. On Date 2, Trustee filed a petition in State Court requesting judicial reformation of the erroneous provision of Paragraph 7.02, effective as of the date Trust was originally created. On Date 3, State Court issued an order reforming Trust to eliminate the scrivener's error retroactive to the date of Trust's creation. The order is contingent upon the issuance of a favorable private letter ruling by the Internal Revenue Service.

The IRS agreed.

Q. SECTIONS 2701-2704 - SPECIAL VALUATION RULES

1. **How Might The Doctrine Of Merger Be Used With A GRAT?** Because a trust is created by separating legal and equitable title to property, merging legal and equitable title to property in one person will, in general, cause the trust to terminate. The doctrine of merger is incorporated in section 402(a)(5) of the UTC, the comment to which states:

> Subsection (a)(5) addresses the doctrine of merger, which, as traditionally stated, provides that a trust is not created if the settlor is the sole trustee and sole beneficiary of all beneficial interests. The doctrine of merger has been inappropriately applied by the courts in some jurisdictions to invalidate self-declarations of trust in which the settlor is the sole life beneficiary but other persons are designated as beneficiaries of the remainder. The doctrine of merger is properly applicable only if all beneficial interests, both life interests and remainders, are vested in the same person, whether in the settlor or someone else. An example of a trust to which the doctrine of merger would apply is a trust of which the settlor is sole trustee, sole beneficiary for life, and with the remainder payable to the settlor's probate estate.

The Restatement (Third) of Trusts § 69, Comment b, states that "[i]f, by operation of law, the legal title to the trust property passes to the beneficiary who has the entire beneficial interest, merger occurs, the trust terminates, and the beneficiary holds the property free of trust. Where the life interest and remainder interest is held by two beneficiaries who are also the only co-trustees, whether merger occurs in favor of the two beneficiaries is uncertain. See Scott and Ascher on Trusts § 11.2.5.

Suppose the grantor and the remainder beneficiaries contribute their respective interests to an LLC in exchange for membership interests that are proportionate to the interests of each such that the grantor receives an interest equal in value to the amount that would be included in the grantor estate if she died at that moment. The LLC would have all the beneficial interests in the GRAT property. If the LLC could become trustee of the GRAT then the doctrine of merger ought to apply. May an LLC serve as trustee? Under the UTC, for example, there is no definition of trustee but there are broad references to "persons" serving as trustee and the definition of person includes entities like an LLC. Some states may impose other limitations. In PLR 201928005, dealing with merger in the context of a GRAT, the IRS notes a state law requirement that a trustee may terminate a CLAT where the annuity and remainder are held by one beneficiary (and concludes the trustee doing so will not cause gain or loss recognition).

Where an LLC cannot serve as trustee, if the LLC managers serve as trustees is that sufficient? The answer is uncertain. The LLC managers are not the LLC.

Would a merger into an LLC be a taxable event for income tax purposes? The answer would seem to be no. Similarly, because the grantor receives an LLC interest having a value equal to what would be in the grantor's estate if the grantor died at that moment concerns like those raised in CCA 201745012 arguably are avoided.

2. GRAT Inclusion. Treas. Reg. §20.2036-1(c)(2)(i) applies section 2036 to a GRAT. When the grantor dies during the GRAT term, an amount of the GRAT is included in the grantor's estate which is sufficient to produce the annuity using the section 720 rate then in effect (with special rules for annuities, that change during the term). As a practical matter, absent a substantial increase in the section 7520 rate between the date of the GRAT and the grantor's death, an extraordinary appreciation, all of a GRAT is included in the Grantor's estate at death. An exception is for GRATs with long terms, perhaps as long as 99 years, because the annuity required to zero out over such a long-term is very low, as discussed below.

In Badgley v. United States, 121 A.F.T.R.2d 2018-1816 (N.D. Ca. 2018) the taxpayer challenged the regulation where the GRAT term was 15 years. The taxpayer lost. The opinion states:

> Plaintiff contends that the Court should disregard the Regulation as an unreasonable interpretation of section 2036 as applied to Patricia's GRAT. *See* Pl. Mot. at 24 (citing *Prof'l Equities v. Commissioner*, 89 T.C. 165 (1987)). Defendant argues that the Regulation is a reasonable interpretation of section 2036 and valid under *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984). Plaintiff does not expressly dispute that *Chevron* applies; instead, Plaintiff claims that the Regulation is interpretive and thus given less deference as compared to a legislative rule. See Pl. Opp. at 19.

> The Court applies *Chevron*'s two-step framework. *See Mayo Found. for Med. Educ. & Research v. United States*, 562 U.S. 44, 52 (2011). At *Chevron* step one, the Court asks "whether Congress has directly addressed the precise question at issue." *Id*. (quotation omitted). The parties agree that section 2036 does not expressly address whether annuity payments constitute some possession, enjoyment, or right to income from the transferred property. Def. Mot. at 14; Pl. Mot. at 19. So the Court proceeds to step two. At that step, the Court "may not disturb an agency rule unless it is arbitrary or capricious in substance, or manifestly contrary to the statute." *Mayo Found. for Med. Educ.*, 562 U.S.at 53 (quotation omitted).
>
> The Court concludes that the Regulation is reasonable, and valid under *Chevron*. In drafting the Regulation, the IRS and Treasury Department relied principally on the above discussed binding authorities, including *Church's, Hallock, and Spiegel's*. *See* Grantor Retained Interest Trusts—Application of Sections 2036 and 2039, T.D. 9414, 73 Fed. Reg. 40173-01 (July 14, 2008) at 40174. Those cases support Defendant's view of section 2036, which parallels the Regulation's interpretation of that section. The IRS and Treasury Department also drew on section 2036's legislative history to devise the Regulation, observing that Congress amended section 811(c) to include interests retained for a term of years. *Id*. (citing H.R. Rep. no. 81-1412 at 9 (1949)). Though Plaintiff cites legislative history for the opposite conclusion, Plaintiff does not explain why that history supports the Regulation. *See* Pl. Opp. at 20.

Overturning a final regulation is difficult. Here the regulation was designed to be anti-taxpayer. Inclusion with one payment to go is calculated the same as on day 2 of the GRAT. The taxpayer appealed arguing that an annuity is not a retained right to income or use, and the valuation approach of the regulations should be thrown out, but the appeal was denied by the Ninth Circuit. <u>Badgley v. United States</u>, 957 F.3d 969 (9th Cir. 2020). The opinion states:

> The fact that § 2036(a)(1) does not include the term "annuity" does not exclude annuities from its ambit. This is consistent with the decisions of the Supreme Court and our sibling circuits, which have concluded that interests such as reversionary interests, the power of appointment, and rent— also not expressly listed in § 2036(a)—nevertheless fall into one of the three categories. *See, e.g., Estate of Spiegel v. Comm'r*, 335 U.S. 701, 705 (1949) (potential reversionary interest in property is possession or enjoyment); *Fid.-Phila. Tr. Co. v. Rothensies*, 324 U.S. 108, 111 (1945) (beneficiaries' estates "took effect in enjoyment" only at transferor's death because she held power of appointment); *Estate of McNichol*, 265 F.2d at 671 (rent from property is enjoyment). As far back as the 1940s, the Supreme Court rejected the proposition that taxpayers could "escape the force of this section by hiding behind the legal niceties contained in devices and forms created by conveyances." *Church's Estate*, 335 U.S. at 646 (quotation omitted); *see also Fid.- Phila.*, 324 U.S. at 111 ("The application of this tax does not depend upon elusive and subtle casuistries." (quotation omitted)). We reject Badgley's argument that because § 2036(a)(1) does not expressly mention annuities, the full value of Decedent's GRAT cannot be included in the gross estate.
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> In *Commissioner v. Clise*, 122 F.2d 998 (9th Cir. 1941), involving annuity contracts outside of the trust context, we concluded that when a grantor retained the "economic benefit" of annuity payments, she retained enjoyment of the

> property. *Id.* at 999, 1003–04. Because the annuities went to Clise for her lifetime and to a designated second annuitant upon her death, "[t]he practical effect of the annuity contracts was to reserve to [her] the enjoyment of the property transferred and to postpone the fruition of the economic benefits thereof to the second annuitants until her death." *Id.* at 1004; *see also Forster v. Sauber*, 249 F.2d 379, 380 (7th Cir. 1957) (holding retained annuity includable in gross estate because "grantor has retained the economic enjoyment of the contracts for life"); *Mearkle's Estate v. Comm'r*, 129 F.2d 386, 388 (3d Cir. 1942) (holding annuity contracts includable because their practical effect was "to reserve to the annuitant the enjoyment of the property transferred and to postpone the fruition of the economic benefits to the second annuitant until after the death of the first"). We conclude that when a grantor derives substantial present economic benefit from property, she retains the enjoyment of the property for purposes of § 2036(a)(1).5 As in *Clise*, Decedent's annuity was a "substantial present economic benefit," requiring inclusion of the GRAT's date of death value in her estate. She received $302,259 per year for fifteen years through the annuity. Moreover, because the partnership was the only property placed in the GRAT, the annuity stemmed from that property interest. As "something of value enjoyed by her," *Bayliss v. United States*, 326 F.2d 458, 461 (4th Cir. 1964), the annuity reserved to Decedent the enjoyment of the partnership interest during her lifetime. And because Decedent died before the termination of the GRAT, the property was not transferred to its beneficiaries before her death—and remained tied to her by the string she created.
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> ***
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> Badgley also challenges 26 C.F.R. § 20.2036-1(c)(2), which includes the formula the IRS uses to calculate the portion of the property includable under § 2036(a). The regulation interprets § 2036(a) to provide that GRATs are includable in a grantor's gross estate because they are sufficiently tied to the grantor.7 Badgley's argument regarding the formula is limited to two sentences and two footnotes, without a single citation to legal authority. As we have previously held, arguments presented in such a cursory manner are waived. Federal Rule of Appellate Procedure 28(a)(8)(A) requires an appellant's opening brief to contain the "appellant's contentions and the reasons for them, with citations to the authorities and parts of the record on which the appellant relies." *Id.* "Arguments made in passing and not supported by citations to the record or to case authority are generally deemed waived." *United States v. Graf*, 610 F.3d 1148, 1166 (9th Cir. 2010).

Suppose the grantor of the GRAT is unlikely to survive the term. A remainder interest purchase strategy was tried in CCA 201745012 which the IRS described as follows:

ISSUES

(1) Whether the remainder interest in transferred property in which the donor has retained an annuity replenishes the donor's taxable estate so as to constitute adequate and full consideration in money or money's worth for gift tax purposes where the purchase of the remainder occurs on the donor's deathbed during the term of the annuity.

(2) Whether a note given in exchange for property that does not constitute adequate and full consideration in money or money's worth for gift tax purposes is deductible as a claim against the estate.

CONCLUSIONS

(1) Where the purchase of the remainder occurs on the donor's deathbed during the term of the annuity, the remainder does not replenish the donor's taxable estate. Accordingly, the remainder does not constitute adequate and full consideration in money or money's worth for gift tax purposes. Merrill v. Fahs, 324 U.S. 308 (1945).

(2) A note given in exchange for property that does not constitute adequate and full consideration in money or money's worth for gift tax purposes is not deductible as a claim against the estate.

The purchase occurred the day before the grantor died. The essence of the replenishment argument was outlined by the IRS:

> In Commissioner v. Wemyss, 324 U.S. 303 (1945), the Supreme Court considered the meaning of the term "adequate and full consideration in money or money's worth" for gift tax purposes. There, the donor transferred assets to his fiancé to compensate her for the loss of an income interest that would terminate upon her marriage to him. There was no dispute that both a promise of marriage and detriment to a contracting party constituted valuable consideration for purposes of the law of contracts. The Tax Court had held that if the promise of marriage was the consideration, it was not one reducible to a money value and if the fiancé's loss of the income interest was the consideration, it did not constitute consideration in the hands of the donor.
>
>> If we are to isolate as an independently reviewable question of law the view of the Tax Court that money consideration must benefit the donor to relieve a transfer by him from being a gift, we think the Tax Court was correct. . . . The section taxing as gifts transfers that are not made for 'adequate and full (money) consideration' aims to reach those transfers which are withdrawn from the donor's estate. To allow detriment to the donee to satisfy the requirement of 'adequate and full consideration' would violate the purpose of the statute and open wide the door for evasion of the gift tax.
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> Wemyss, 324 U.S. at 307-08. In other words, valuable contractual consideration in the hands of the donor is not sufficient; adequate and full consideration is that which replenishes, or augments, the donor's taxable estate.
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> Wemyss had a companion case, Merrill v. Fahs, 324 U.S. 308 (1945), which was also a gift tax case. Merrill and its predecessors likewise involved situations where A transferred property to B, A's fiancé or spouse, in exchange for B's

> relinquishment of marital rights in A's remaining property. Both Wemyss and Merrill have come to stand for the general proposition that "adequate and full consideration in money or money's worth" for gift tax purposes is that which replenishes, or augments, the donor's taxable estate. See Steinberg v. Commissioner, 141 T.C. 258, 266 (2013) (noting that under the estate depletion theory, a donor receives consideration in money or money's worth only to the extent that the donor's estate has been replenished), citing Wemyss, at 307-08, and Randolph E. Paul, Federal Estate and Gift Taxation, para. 16.14, at 1114-15 (1942).1 See also I.R.C. § 2043(b)(1) ("Transfers for Insufficient Consideration"). Thus, B's relinquishment of marital rights in A's property will have no effect on the includible value of that property in A's gross estate. Accordingly, the relinquishment of marital rights cannot replenish a donor's gross estate for estate tax purposes, and thus cannot constitute adequate and full consideration for gift tax purposes. See also Commissioner v. Bristol, 121 F.2d 129, 136 (1st Cir. 1941).
>
> It is important to keep in mind that in each of the above cases, the relinquishment of the marital rights in the donor's remaining assets did constitute valuable contractual consideration in the hands of the donor, and did benefit the donor. It enabled the donor to dispose of that property free of the spousal claims of the second marriage. See Merrill v. Fahs, 324 U.S. at 309. For instance, Bristol involved the waiver of spousal claims against a family business that the donor wished to bequeath to the children of his first marriage. Bristol, 121 F.2d at 131. Indeed, in each of these cases, it was the prospective husband's desire to dispose of his property as he chose that was the basis of the ante-nuptial agreement. This freedom did not constitute adequate and full consideration, however, because it did not augment the husband's taxable estate.
>
> Here, it cannot be disputed that Donor's liability on the promissory notes depleted Donor's taxable estate. However, in the context of a deathbed purchase of a remainder interest in transferred property in which a donor has retained a § 2036 "string," the receipt of the remainder does not increase the value of the donor's taxable estate, because the value of the entire property, including that of the remainder, will be includible in the donor's gross estate pursuant to § 2036(a)(1). Thus, Donor's receipt of the remainder interests cannot constitute adequate and full consideration within the meaning of § 2512(b). Commissioner v. Wemyss, 324 U.S., at 307-08. Cf. Rev. Rul. 98-8, 1998-1 C.B. 541 (reaching a similar conclusion for gift tax purposes in the context of §§ 2519 and 2044.) Accordingly, Donor has made a completed gift to the beneficiaries of Trust 1 in the amount of the value of the promissory notes transferred to Trust 1.

The CCA repeatedly notes the "deathbed" nature of the transaction. It is unclear if an earlier purchase would have mattered, if at such time the entire GRAT would have been included in the grantor's estate.

When the section 7520 rate is extremely low, a very long-term GRAT will require extremely low annuity payments to zero-out. For example, a 99 year term GRAT when the 7520 rate is 0.6% requires an annuity of 1.342568% to zero-out. If the 7520 rate thereafter increases to 3% (the April 2019 rate) only 44.75239% of the GRAT assets would be included in the grantor/annuitant's estate.

3. Grandfathered Buy-Sell Status Unaffected By Changes and Recapitalization. In PLR 202014006 the issue was whether various transactions would terminate the grandfathered status of a buy-sell agreement in effect on October 8, 1990. Various transfers of shares to trusts were discussed and two corporate changes described as follows:

> Ruling #2
>
> On Date 7, a date after October 8, 1990, Company amended the Articles to change its name to the current name. On Date 8, Company amended and restated the Articles. Also on Date 8, Company amended and restated the Bylaws that included administrative changes such as name change, indemnification, and number of members constituting the Board of Directors.
>
> Based upon the facts submitted and representations made, we conclude that none of the amendments to the Articles on Date 7, the amendments and restatement of the Articles on Date 8, and the amendment and restatement of the Bylaws on Date 8 constitute substantial modifications of any right or restriction in the Articles, the Bylaws, or the Agreement within the meaning of § 25.2703-1(c). Consequently, we conclude that the Articles, the Bylaws, and the Agreement continue to be grandfathered for purposes of chapter 14.
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> Ruling #3
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> The proposed Plan of Recapitalization includes a stock split of one share of Company common stock into one share of Class A voting common stock and x shares of Class B nonvoting common stock. The Articles and Agreement will be amended to reflect the stock split and the addition of Class B nonvoting common stock to the capital structure. The issuance of the Class B nonvoting common stock does not change the terms and conditions to which the shareholders are already subject. In addition, the beneficial interest in the Company will not be affected by the stock split because each shareholder of common stock will receive x shares of Class B nonvoting common stock for every share of common stock held prior to the recapitalization. Accordingly, we conclude that the recapitalization does not affect the quality, value, or timing of any rights of the parties to the Agreement.
>
> Based upon the facts submitted and representations made, we conclude that the proposed Plan of Recapitalization, the proposed amendments to the Articles and Agreement to reflect the stock split and the addition of Class B nonvoting common stock to the capital structure, and the issuance of Class B nonvoting common stock, will not constitute substantial modifications of the Agreement or the Articles within the meaning of § 25.2703-1(c). Further, we conclude that the proposed Plan of Recapitalization and the proposed amendments, described above, will not cause § 2703 to apply to transfers of shares of Company stock subject to the Agreement, as amended.

The ruling was one of a series. See also PLR 202015004, one of a series; and PLR 202017012.

R. SECTION 6166 — EXTENSION OF TIME TO PAY TAX

1. **Section 6166 Election Approved**. In PLR 201928007 the IRS concluded that various units of a closely-held corporation were carrying on a trade or business. The ruling states the background law as follows:

> Under section 6166(a)(1), if the value of an interest in a closely held business that is included in determining the gross estate of a decedent exceeds 35 percent of the

adjusted gross estate, the estate may elect to pay all or part of the tax imposed by section 2001 (the estate tax liability) in two or more (but not exceeding ten) equal installments. Under section 6166(a)(2), the maximum amount of tax that may be deferred is the percentage of estate tax equal to the percentage of the adjusted gross estate that is comprised of the closely held business amount. Under section 6166(a)(3), if the estate makes an election under section 6166(a)(1), the estate has up to five years from the due date prescribed by section 6151(a) to make the first installment payment.

Pursuant to IRC 6166(b)(1) an" interest in a closely held business" is defined, in relevant part, as: stock in a corporation carrying on a trade or business if 20% or more of the value of voting stock of the corporation is included in the gross estate, or the corporation has 45 or fewer shareholders.

Revenue Ruling 2006-34 contains a non-exclusive list of factors that are relevant in determining whether real property interests are interests in a closely held business for purposes of section 6166: the amount of time the corporation's employees devoted to the trade or business; whether an office was maintained from which the activities of the corporation were conducted and whether the corporation maintained regular business hours for that purpose; the extent to which the corporation's employees were actively involved in finding new tenants and negotiating and executing leases; the extent to which the corporation's employees provided services beyond the mere furnishing of leased premises; the extent to which the corporation's employees personally arranged for, performed, or supervised repairs and the maintenance of property (whether or not performed by independent contractors); and the extent to which the corporation's employees handled tenant repair requests and complaints. Although Revenue Ruling 2006-34 addresses interests in real estate, the factors in the revenue ruling are helpful in evaluating whether other interests are those of an active trade or business.

The ruling approves various activities as follows:

According to the facts provided, Operating Unit 2 is responsible for providing remarketing, management and support services regarding equipment owned by Operating Unit 1 and Division 1 (a division of Operating Unit 1), and equipment owned by outside lessors. Operating Unit 2 has Number 1 full- time-equivalent employees that are involved in management, support, remarketing, sale and re-lease of the equipment. Operating Unit 2 has Number 2 locations and Number 3 off-site warehouse maintained where activities are conducted. Most lessees and customers are secured through direct activities of Operating Unit 2, and the repair of equipment is either arranged for, performed by, or supervised by an employee of Operating Unit 2.

***

The facts provide that employees of Operating Unit 3 are involved in day-to-day operations, management, and maintenance of commercial class properties. Operating Unit 3 has Number 4 full-time-equivalent employees that work out of company offices in City, State. The employees of Operating Unit 3: find new tenants; negotiate and execute leases; arrange for, perform, and supervise property repairs and maintenance; and, handle tenant repair and maintenance requests, and complaints. Additionally, the employees hire and supervise independent contractors for substantial repairs and capital improvements, and services such as snow removal, landscaping, security, janitorial, and cafeteria services.

***

> The facts given provide that the Operating Unit 5 has Number 5 full-time equivalent non-owner employees overseeing all facets of construction and supervising operations of Company 2, an independent property management firm.
>
> Applying Revenue Ruling 2006-34 to this situation, it appears that Company 2 is acting as an independent contractor of Operating Unit 5. The use of independent contractors to perform work does not prevent the business activities from rising to the level of the conduct of an active trade or business provided that the third-party activities do not reduce the activities of the corporation to merely holding investment property. From the facts provided, Operating Unit 5 involves non-owner employees of Company 1 actively overseeing construction of the subject properties and actively supervising the actions of Company 2. Therefore the activities of Operating Unit 5 constitute the carrying on of a trade or business for purposes of section 6166.

***

> The facts presented provide that Operating Unit 6 relies on Company 3, their hotel management company, to operate and manage the subject hotel and restaurant. Operating Unit 6 has no ownership interest in Company 3. However, the facts provide that even though Company 3 operates, maintains, services, and improves the hotel, employees of Operating Unit 6 are involved in a daily basis in all aspects of the management and food service of the hotel.
>
> Applying Revenue Ruling 2006-34 to this situation, it appears that Company 3 is acting as an independent contractor of Operating Unit 6. The use of independent contractors to perform work does not prevent the business activities from rising to the level of the conduct of an active trade or business provided that the third-party activities do not reduce the activities of the corporation to merely holding investment property. Even though Company 3 is involved in the management of the hotel, Operating Unit 6 is not merely holding an investment property. Therefore, the activities of Operating Unit 6 constitute the carrying on of a trade or business for purposes of section 6166.

S. TAX ADMINISTRATION

1. **Priority Guidance Plan**. 2019-2020 (through June 20, 2020).

PART 1. INITIAL IMPLEMENTATION OF TAX CUTS AND JOBS ACT (TCJA)

* * *

46. Regulations under § 2010 addressing the computation of the estate tax in the event of a difference between the basic exclusion amount applicable to gifts and that applicable at the donor's date of death. [Note: Final Regulations Now Issued; discussed above.]

* * *

PART 3. NEAR-TERM BURDEN REDUCTION

5. Guidance under § 170(e)(3) regarding charitable contributions of inventory.

13. Regulations under §§ 1014(f) and 6035 regarding basis consistency between estate and person acquiring property from decedent. Proposed and temporary regulations were published on March 4, 2016.

* * * *

17. Final regulations under § 2642(g) describing the circumstances and procedures under which an extension of time will be granted to allocate GST exemption.

PART 6. GENERAL GUIDANCE

* * *

EMPLOYEE BENEFITS

A. Retirement Benefits

3. Regulations under § 401(a)(9) updating life expectancy and distribution tables for purposes of the required minimum distribution rules and addressing certain other issues under section 401(a)(9). [Note: Proposed Regulations Issued November 8, 2019. REG-132210-18.]

EXEMPT ORGANIZATIONS

5. Guidance under §4941 regarding a private foundation's investment in a partnership in which disqualified persons are also partners.

6. Regulations regarding the excise taxes on donor advised funds and fund management.

* * *

GIFTS AND ESTATES AND TRUSTS

1. Guidance on basis of grantor trust assets at death under § 1014.

2. Final regulations under § 2032(a) regarding imposition of restrictions on estate assets during the six month alternate valuation period. Proposed regulations were published on November 18, 2011.

3. Regulations under § 2053 regarding personal guarantees and the application of present value concepts in determining the deductible amount of expenses and claims against the estate.

4. Regulations under § 7520 regarding the use of actuarial tables in valuing annuities, interests for life or terms of years, and remainder or reversionary interests.

INSURANCE COMPANIES AND PRODUCTS

1. Final regulations under § 72 on the exchange of property for an annuity contract. Proposed regulations were published on October 18, 2006.

2. **No Ruling Positions**. In Rev. Proc. 2020-3 the IRS provided issues on which it will not rule. Among those are:

> (38) Section 170.—Charitable. Etc., Contributions and Gifts.—Whether a charitable contribution deduction under § 170 is allowed for a transfer of an interest in a limited partnership or a limited liability company taxed as a partnership to an organization described in § 170(c).
>
> (39) Section 170.—Charitable, Etc., Contributions and Gifts.—Whether a taxpayer who advances funds to a charitable organization and receives therefor a promissory note may deduct as contributions, in one taxable year or in each of several years, amounts forgiven by the taxpayer in each of several years by endorsement on the note.
>
> (81) Sections 507, 664, 4941, and 4945.—Termination of Private Foundation Status; Charitable Remainder Trusts; Taxes on Self-Dealing; Taxes on Taxable Expenditures.—Issues pertaining to the tax consequences of the termination of a charitable remainder trust (as defined in § 664) before the end of the trust term as defined in the trust's governing instrument in a transaction in which the trust beneficiaries receive their actuarial shares of the value of the trust assets.
>
> (89) Section 643(f).—Treatment of multiple trusts.—Whether two or more trusts shall be treated as one trust for purposes of subchapter J of chapter 1.
>
> (92) Section 671.—Trust Income, Deductions, and Credits Attributable to Grantors and Others as Substantial Owners.—Whether the grantor will be considered the owner of any portion of a trust when (i) substantially all of the trust corpus consists or will consist of insurance policies on the life of the grantor or the grantor's spouse, (ii) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (iii) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, and (iv) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under §§ 673 to 677.
>
> (93) Section 671.—Trust Income, Deductions, and Credits Attributable to Grantors and Others as Substantial Owners.—Whether any portion of the items of income, deduction, and credit against tax of the trust will be included in computing under § 671 the taxable income, deductions and credits of grantors when distributions of income or corpus are made – (A) at the direction of a committee, with or without the participation of the grantor, and (1) a majority or unanimous agreement of the committee over trust distributions is not required, (2) the committee consists of fewer than two persons other than a grantor and a grantor’s spouse; or (3) all of the committee members are not beneficiaries (or guardians of beneficiaries) to whom all or a portion of the income and principal can be distributed at the direction of the committee or (B) at the direction of, or with the consent of, an adverse party or parties, whether named or unnamed under

the trust document (unless distributions are at the direction of a committee that is not described in paragraph (A) of this section).

(98) Section 1001.—Determination of Amount of and Recognition of Gain or Loss.—Whether the termination of a charitable remainder trust before the end of the trust term as defined in the trust's governing instrument, in a transaction in which the trust beneficiaries receive their actuarial shares of the value of the trust assets, is treated as a sale or other disposition by the beneficiaries of their interests in the trust.

(110) Section 2055.—Transfers for Public, Charitable, and Religious Uses.—Whether a charitable contribution deduction under § 2055 is allowed for the transfer of an interest in a limited partnership or a limited liability company taxed as a partnership to an organization described in § 2055(a).

(112) Section 2522.—Charitable and Similar Gifts.—Whether a charitable contribution deduction under § 2522 is allowable for a transfer of an interest in a limited partnership or a limited liability company taxed as a partnership to an organization described in § 2522(a).

(113) Section 2601.—Tax Imposed.— Whether a trust exempt from generation-skipping transfer (GST) tax under § 26.260l — l(b)(1), (2), or (3) of the Generation-Skipping Transfer Tax Regulations will retain its GST exempt status when there is a modification of a trust, change in the administration of a trust, or a distribution from a trust in a factual scenario that is similar to a factual scenario set forth in one or more of the examples contained in § 26.2601-1 (b)(4)(i)(E).

(121) Section 4941.—Taxes on Self- Dealing.—Whether transactions during the administration of an estate or trust meet the requirements of the exception to § 4941 set forth in § 53.4941(d)-1(b)(3) of the Private Foundation Excise Tax Regulations, in cases in which a disqualified person issues a promissory note in exchange for property of an estate or trust.

In addition, rulings will "not ordinarily" be issued on the issues below. "Not ordinarily" means that unique and compelling reasons must be demonstrated in order for a ruling to be issued.

(20) Section 170.—Charitable, Etc., Contributions and Gifts.—Whether a taxpayer who transfers property to a charitable organization and thereafter leases back all or a portion of the transferred property may deduct the fair market value of the property transferred and leased back as a charitable contribution.

(40) Section 664.—Charitable Remainder Trusts.—Whether a trust that will calculate the unitrust amount under § 664(d)(3) qualifies as a § 664 charitable remainder trust when a grantor, a trustee, a beneficiary, or a person related or subordinate to a grantor, a trustee, or a beneficiary can control the timing of the trust's receipt of trust income from a partnership or a deferred annuity contract to take advantage of the difference between trust income under § 643(b) and income for Federal income tax purposes for the benefit of the unitrust recipient.

(43) Section 678.—Person Other than Grantor Treated as Substantial Owner.—Whether a person will be treated as the owner of any portion of a trust over which that person has a power to withdraw the trust property (or had such power prior to a release or modification, but retains other powers which would cause that person to be the owner of the trust under § 671 if the person were the grantor),

other than a power which would constitute a general power of appointment within the meaning of § 2041. if the trust purchases the property from that person with a note and the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

(49) Sections 2035, 2036, 2037, 2038, and 2042.—Adjustments for Certain Gifts Made Within Three Years of Decedent's Death; Transfers with Retained Life Estate; Transfers Taking Effect at Death; Revocable Transfers; Proceeds of Life Insurance.—Whether trust assets are includible in a trust beneficiary's gross estate under § 2035, 2036. 2037, 2038, or 2042 if the beneficiary sells property (including insurance policies) to the trust or dies within 3 years of selling such property to the trust, and (i) the beneficiary has a power to withdraw the trust property (or had such power prior to a release or modification, but retains other powers which would cause that person to be the owner if the person were the grantor), other than a power which would constitute a general power of appointment within the meaning of § 2041, (ii) the trust purchases the property with a note, and (iii) the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

(52) Section 2501.—Imposition of Tax.—Whether the sale of property (including insurance policies) to a trust by a trust beneficiary will be treated as a gift for purposes of § 2501 if (i) the beneficiary has a power to withdraw the trust property (or had such power prior to a release or modification, but retains other powers which would cause that person to be the owner if the person were the grantor), other than a power which would constitute a general power of appointment within the meaning of § 2041, (ii) the trust purchases the property with a note, and (iii) the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

(53) Section 2503.—Taxable Gifts.— Whether the transfer of property to a trust will be a gift of a present interest in property when (i) the trust corpus consists or will consist substantially of insurance policies on the life of the grantor or the grantor's spouse, (ii) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (iii) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, (iv) the trust beneficiaries have the power to withdraw, on demand, any additional transfers made to the trust, and (v) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under §§ 673 to 677.

(54) Section 2514.—Powers of Appointment.—If the beneficiaries of a trust permit a power of withdrawal to lapse, whether § 2514(e) will be applicable to each beneficiary in regard to the power when (i) the trust corpus consists or will consist substantially of insurance policies on the life of the grantor or the grantor's spouse, (ii) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (iii) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, (iv) the trust beneficiaries have the power to withdraw, on demand, any additional transfers made to the trust, and (v) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under §§ 673 to 677.

(57) Section 2601.—Tax Imposed.— Whether a trust that is exempt from the application of the generation-skipping transfer tax because it was irrevocable on

September 25, 1985, will lose its exempt status if the situs of the trust is changed from the United States to a situs outside of the United States.

(58) Section 2702.—Special Valuation Rules in Case of Transfers of Interests in Trusts.—Whether annuity interests are qualified annuity interests under § 2702 if the amount of the annuity payable annually is more than 50 percent of the initial net fair market value of the property transferred to the trust, or if the value of the remainder interest is less than 10 percent of the initial net fair market value of the property transferred to the trust. For purposes of the 10 percent test, the value of the remainder interest is the present value determined under § 7520 of the right to receive the trust corpus at the expiration of the term of the trust. The possibility that the grantor may die prior to the expiration of the specified term is not taken into account, nor is the value of any reversion retained by the grantor or the grantor's estate.

(59) Section 2702.—Special Valuation Rules in Case of Transfers of Interests in Trusts.—Whether a trust with one term holder satisfies the requirements of § 2702(a)(3)(A) and § 25.2702-5(c) to be a qualified personal residence trust.

(60) Section 2702.—Special Valuation Rules in Case of Transfers of Interests in Trusts.—Whether the sale of property (including insurance policies) to a trust by a trust beneficiary is subject to § 2702 if (i) the beneficiary has a power to withdraw the trust property (or had such power prior to a release or modification, but retains other powers which would cause that person to be the owner if the person were the grantor), other than a power which would constitute a general power of appointment within the meaning of § 2041, (ii) the trust purchases the property with a note, and (iii) the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

Finally, rulings related to private trust companies, decanting, or the basis adjustment, if any, of assets owned by a grantor trust, will not be issued until the IRS resolves the issue through publication of a revenue ruling, revenue procedure, or regulations.

3. Effectiveness of Wandry-Like Defined Value Clause. Significant gifts were alleged by the IRS in cases involving the True family, at Karen S. True v. Commissioner, Tax Court Docket No. 21896-16, and H.A. True III v. Commissioner, Tax Court Docket No. 21897-16 (petitions filed October 11, 2016). The gifts were made with adjustment clauses that moved amounts in excess of the stipulated (and desired) gift of about $34,000,000 into sales with the "donee" children owing none on a note. The IRS argued that the gifts were about $95 million more than the $34 million number. The cases settled for an additional $4 million in gift tax (and an unknown amount, if any, note adjustment).

4. Gift Tax Protective Refund Claims Allowed. CCA 201906006 notes that a protective refund claim for gift taxes may be made. There is no indication of a situation where such would be helpful but it is good to know.

5. Alleged Failure to Advise About Basis. A complaint styled Raia v. Lowenstein Sandler has been filed in the Superior Court of New Jersey Law Division: Civil Part, Bergen County (BER-L-000921-19). The essence of the action is the supposed failure of counsel to advise clients that assets given to dynasty trusts retain carryover basis and potential particular problems that could result from depreciation recapture upon the trusts ceasing to be grantor trusts when the grantor died. Regardless of the merits – if any – of the action, it is a reminder for estate planners.

6. **Income Tax Transferee Liability**. An interesting income tax transferee liability arose in Hawk v. Commissioner, 924 F.3d 821 (6th Cir. 2019). The opinion summarizes the facts:

> After Billy Hawk died in 2000, his wife Nancy Sue decided to sell the family bowling business, Holiday Bowl. With the help of lawyers and accountants, she made a deal with MidCoast, a company that claimed an interest in acquiring companies with corporate tax liabilities that it could set off against its net-operating losses. Holiday Bowl first sold its assets—bowling alleys—to Bowl New England, receiving $ 4.2 million in cash and generating about $ 1 million in federal taxes. After that, Nancy Sue and Billy's estate sold Holiday Bowl to MidCoast for about $ 3.4 million, in essence exchanging one pile of cash for another minus the tax debt MidCoast agreed to pay. But MidCoast never paid the taxes. The United States filed this transferee-liability action against Nancy Sue Hawk and Billy Hawk's estate to recover Holiday Bowl's unpaid taxes. The Tax Court ruled for the government, concluding that the Hawks were transferees of a delinquent taxpayer under federal law and permitting the government to recover the unpaid taxes from the Hawks under Tennessee law. We affirm.

The court found it helpful to illustrate the general scheme of section 6901, which allows the federal government to have the status of a private creditor pursuing the transferee in federal court. The opinion provides two examples:

> Two examples illustrate what § 6901 is getting at. Imagine Company A. It has $ 5 million in assets that have a basis (cost) of $ 1 million. Let's say Company A sells its assets (a manufacturing plant) to Company B for cash. At that point, Company A would owe federal taxes on the $ 4 million gain generated by the sale. But suppose that Company A's owners decide not to pay Company A's taxes. They instead pay themselves $ 5 million and simply let Company A go belly-up, leaving Company A's taxes unpaid. That leaves a classic transferee liability for the owners under § 6901.
>
> What happens, however, if the owners try to avoid that liability with an intermediary transaction? The owners sell Company A to a foreign Company C for $ 5 million—the exact amount of money that Company A has in the bank. This leaves the owners with $ 5 million, and Company C with $ 5 million in Company A, and Company A still needing to pay its taxes. Because Company C is outside the United States, the government might not be able to pursue Company C as a transferee when it empties Company A's coffers and no one pays A's taxes. In this setting, a court might decide that the sale of Company A had no economic substance to it, and that the owners *really* transferred Company A's cash directly to themselves.

So, which scenario might apply here? The transaction at issue was described as follows:

> After Billy Hawk's death in 2000, Nancy Sue owned almost a fifth of the company's stock and her husband's estate owned the remainder. Billy and Nancy Sue's two sons operated the two bowling alleys awhile. But that didn't work. By

> 2002, she realized she needed to sell Holiday Bowl. She chose an asset sale to Bowl New England. The sale left Holiday Bowl with $ 4.2 million in cash and left the company owing about $ 1 million in federal income taxes and about $ 200,000 in state taxes. Holiday Bowl also owned some real property, a family horse farm that Nancy Sue wanted to keep, valued at $ 777,000.
>
> Trying to lower the corporate taxes triggered by the transaction, the Hawks' broker approached their attorney with information about a company called MidCoast that had "tremendous tax-loss carry-forwards." J.A. 3 at 797. If MidCoast bought Holiday Bowl, the broker advertised, Holiday Bowl would not need to pay corporate taxes on the asset sale. As a result, MidCoast promised to pay the Hawks more than Holiday Bowl's actual value—what would have been its cash on hand minus outstanding taxes. Nancy Sue Hawk and the estate stood to keep an extra $ 200,000 to $ 300,000 by structuring the transaction in this way. MidCoast purported to offer Holiday Bowl a way to realize the best attributes of an asset sale (the higher sale price of the assets) and a stock sale (no corporate-level tax). In closing his recommendation, the broker, warily but not warily enough, said: "[I]f it seems too good to be true, it probably is. But maybe this is the exception." *Id.* at 798.
>
> The Hawks proceeded to enjoy what looked like a free lunch. Under the purchase agreement, the Hawks sold Holiday Bowl some of their shares in exchange for the company's remaining property, the horse farm. That left Holiday Bowl with nothing but cash. MidCoast paid $ 3.4 million plus expenses for Holiday Bowl's $ 4.2 million. To finance the transaction, MidCoast claimed it would borrow money from a company called Sequoia Capital. According to MidCoast, Holiday Bowl would then enter the debt-collection business, rapidly generating new losses that would offset Holiday Bowl's existing taxes.
>
> After the sale, MidCoast transferred Holiday Bowl to Sequoia in exchange for the cancellation of Sequoia's loan and about $ 320,000 in cash. No one ever paid Holiday Bowl's outstanding taxes, and the one-time bowling company dissolved in 2006.
>
> The Internal Revenue Service investigated MidCoast, uncovering the Holiday Bowl sale and about sixty similar transactions. That did not end well for MidCoast, Sequoia, and a law firm, as a grand jury indicted several individuals associated with each of them. One defendant pleaded guilty. Others fled the country. The government launched a civil collection proceeding against the Hawks in pursuit of Holiday Bowl's unpaid taxes. The Tax Court concluded that Sequoia's loan to MidCoast was a sham and that Holiday Bowl had simply distributed cash to the Hawks, who were liable to the government as Holiday Bowl's fraudulent transferees. This appeal followed.

At issue was the "reality" of the transaction. The government's position was that in essence the Harks got Holiday Bowl's money. The court agreed:

> The Tax Court permissibly refused to respect several features of the form that MidCoast and the Hawks tried to place on this transaction. Start with the ostensibly independent financing of it: the Sequoia loan. The Tax Court found that the Hawks didn't even get Sequoia's (ostensibly) loaned funds. They got Holiday Bowl's own funds, which were wired into an escrow account and promptly funneled back from the same escrow account to the Hawks. The quintessential explanation for refusing to respect the form of a transaction is that it amounts to a charade. What purported to be real, a Sequoia loan to MidCoast to

> finance the sale, was not in fact real, as MidCoast paid for the transaction with Holiday Bowl funds.
>
> Even aside from tracing where the dollars and cents came from and where they eventually went, the Sequoia loan looked like an impostor on paper. Under the terms of the deal, Sequoia had no risk because Holiday Bowl's own cash served as the collateral for the loan. The idea was that lenders traditionally require security for a loan. And this loan looked like it had security. But an immediately repayable, cash-for-cash loan backed up by cash is not a traditional loan. Money is fungible. So is air. By getting a "loan" from Sequoia, MidCoast could access cash, which it then could immediately pay back with Holiday Bowl's own money—in effect using Holiday Bowl's bank account at no risk to Sequoia. In this setting, the security was no security at all.
>
> It gets worse. The parties didn't sign most of the loan documents, behavior that does not accord with the way people usually transfer large pots of money. Interest and periodic payments are a classic hallmark of real loans. *See Roth Steel Tube Co. v. Comm'r*, 800 F.2d 625, 631 (6th Cir. 1986). But Sequoia's loan wouldn't incur interest unless MidCoast defaulted. While Sequoia did stand to make about $ 17,250 when MidCoast paid back the loan, this translated to annual interest of $ 6.3 million, nearly double what MidCoast borrowed. At dusk's end, Holiday Bowl distributed its money to the Hawks, in substance if not always in form, making them the company's transferees.
>
> The problem by the way is not that the Hawks were trying to lower their taxes. No American to our knowledge prefers a higher tax bill. There are other ways to express fealty to our country. The problem is that the transaction lacked economic substance; it was nothing but misleading labels and distracting forms—trompe l'oeil from start to finish.

There was a final step. Under Tennessee law, could the government, as a creditor, collect? The Sixth Circuit held that it could:

> First, for many of the same reasons the Holiday Bowl transaction amounts to a *transfer* to the Hawks under federal law, it counts as a transfer from Holiday Bowl to the Hawks under Tennessee law. Tennessee law defines a transfer broadly to include "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with an asset or an interest in an asset, and includes payment of money, release, lease, and creation of a lien or other encumbrance." *Id.* § 66-3-302(12). Apt is the word "indirect." Even if the Hawks received Sequoia's money (which they didn't), the Hawks still would have received Holiday Bowl's funds indirectly.
>
> Tennessee courts also consider the economic substance of the Holiday Bowl transaction. The Uniform Fraudulent Transfer Act incorporates traditional "principles of ... equity." *Id.* § 66-3-311. And Tennessee courts have long relied on sham-transaction principles in settings like this one. *See, e.g.*, *CAO Holdings, Inc. v. Trost*, 333 S.W.3d 73, 88 (Tenn. 2010); *M. & M. Stamp Co. v. Harris*, 212 Tenn. 158, 368 S.W.2d 752, 755 (1963). The Tennessee statute also directs that it "shall be applied and construed to effectuate its general purpose to make uniform the law with respect to the subject of this [statute] among states enacting it." Tenn. Code Ann. § 66-3-312. And other courts have held that the sham-transaction principles apply to other States' Uniform Fraudulent Transfer Acts. *See, e.g.*, *Feldman*, 779 F.3d at 459 (interpreting the Wisconsin statute); *In re AFI Holding, Inc.*, 525 F.3d 700, 708 (9th Cir. 2008) (interpreting the California statute).

> Second, Holiday Bowl didn't receive *reasonably equivalent value* for the horse farm or the cash that the company transferred to the Hawks. The Act defines value as "property" transferred or "an antecedent debt ... secured." Tenn. Code Ann. § 66-3-304(a). When the Hawks exchanged stock for the horse farm, the transaction merely subtracted from Holiday Bowl's balance sheet. And Holiday Bowl got nothing when the Hawks received their $ 3.4 million.
>
> Third, Holiday Bowl also became *insolvent* due to this transaction. After the Hawks received their cash back, Holiday Bowl had only about two-thirds of the money that it needed to pay its outstanding taxes.

The court ends with an interesting philosophical flourish:

> For those readers still with us, you might wonder: Was there a way to make this tax-reduction strategy work? Was it ever possible for MidCoast to offset Holiday Bowl's taxes with net operating losses, say by making the Sequoia loan a kosher one and dotting another "i" and crossing another "t" in the underlying transactions? The answer is "maybe" in the abstract and "not likely" here.
>
> As one treatise puts it, "Congress, with assistance from the courts, has constructed a formidable defense against taxpayer efforts to traffic in net operating losses and other corporate tax benefits." Boris I. Bittker & James S. Eustice, *Federal Income Taxation of Corporations and Shareholders* § 14.02 (7th ed. 2019). The Internal Revenue Code prevents a company with pre-existing losses from purchasing a company with pre-existing gains and canceling the two out within five years of the sale. *See* 26 U.S.C. § 384; Bittker & Eustice, *supra*, § 14.45.
>
> That's why MidCoast told the Hawks that it would operate Holiday Bowl as a debt-collection business and generate new losses within Holiday Bowl—a different strategy from the one the broker originally proposed. For this scheme to eliminate Holiday Bowl's 2003 taxes, it appears, the new losses needed to arise between the November 2003 sale and the end of the year. After hearing the evidence, the Tax Court concluded that "[i]t was not plausible" that a MidCoast-owned Holiday Bowl could ever incur the necessary "offsetting expenses" in time. J.A. 3 at 481.
>
> That reality and others too separate this case from *Summa Holdings, Inc. v. Commissioner*, 848 F.3d 779 (6th Cir. 2017). Those taxpayers sought to take advantage of two investment vehicles—a "domestic international sales corporation" and a Roth IRA. The former allows an exporter to shelter certain income from corporate tax. *Id.* at 782. The latter allows individuals to save limited amounts tax free. *Id.* at 783. Done together, a Roth IRA owning shares in a domestic international sales corporation permits taxpayers to transfer (and potentially grow) many assets in their Roth IRAs and spare themselves considerable taxes. *Id.*
>
> That's exactly what the *Summa Holdings* taxpayers did. Citing the substance-over-form doctrine, however, the Commissioner claimed authority to ignore the form of the legislatively approved transactions. We disagreed because "[the] Internal Revenue Code allowed" the taxpayers "to do what they did." *Id.* at 784. Courts (and agencies) must respect a statute's text, and the Commissioner's revision took the substance-over-form doctrine a "step too far." *Id.* at 785. The Commissioner, we acknowledged, may "honor the fiscal realities of what taxpayers have done over the form in which they have done it." *Id.* But neither the

> Commissioner in particular nor the Executive Branch in general may rewrite "the meaning of statutes" whenever it dislikes the law. *Id.*
>
> Think about it. Everyone in *Summa Holdings* agreed that the plain terms of the relevant statutes permitted the transaction. *Id.* at 784. Not even *Chevron* permits government agencies to ignore the plain text of a statute. *Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 842–43, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984). What, then, made the Internal Revenue Service think it could ignore the plain text of a statute—one that other agencies could not override under *Chevron*—under the substance-over-form doctrine? This version of the doctrine makes *Chevron* look like a modest assumption of executive power. When all was said and done, *Summa Holdings* was a case in which the taxpayers forced the government to play it straight—to make *it* respect the form and substance of the laws Congress wrote.
>
> That leaves two sides to the substance and form coin. On one side is *Summa Holdings*. If Congress authorizes taxpayers to do something—in *Summa Holdings*, employing Code-compliant "shell corporations ... that have no economic substance"—the Commissioner can't override the constitutional forces of bicameralism and presentment. *Summa Holdings*, 898 F.3d at 786. On the other side is the Hawks' case. The government isn't seeking to ignore the form of the Code today. It's enforcing the statutes as written. No one disputes that Holiday Bowl owed taxes that the Code imposes. The Code places substantial limits on even the above-board version of this transaction, limits that foreclosed MidCoast's ability to offset Holiday Bowl's pre-existing gains. What's more, § 6901 provides a mechanism for the government to pursue a delinquent taxpayer's assets in cases just like this one. Tennessee law seeks a similar end. All in all, the Commissioner isn't disregarding statutory text in the name of economic substance; he's honoring the written word and the economic realities of this transaction.
>
> We affirm.

The Supreme Court denied cert.

7. **<u>Section 9100 Relief Allowed For Late Section 663(b) Election</u>**. Section 663(b) allows estate or trust distributions within 65 days after the end of the estate, or trust's taxable year to "count" as having been made on the last day of the taxable year. An election is required on the applicable form 1041. What if the election is not made or is late? PLR 201928010 states:

> Section 1.663(b)-2(a)(1) of the Income Tax Regulations provides that if a trust return is required to be filed for the taxable year of the trust for which the election is made, the election shall be made in the appropriate place on such return. The election under § 1.663(b)-2(a)(1) shall be made not later than the time prescribed by law for filing such return (including extensions thereof). Such election shall become irrevocable after the last day prescribed for making it.
>
> Section 301.9100-1(c) provides that the Commissioner may grant a reasonable extension of time under the rules set forth in §§ 301.9100-2 and 301.9100-3 to make a regulatory election, or a statutory election (but not more than 6 months except in the case of a taxpayer who is abroad), under all subtitles of the Code except subtitles E, G, H, and I. Section 301.9100-1(b) provides that the term

"regulatory election" includes an election whose due date is prescribed by a regulation published in the Federal Register.

Section 301.9100-2 provides the rules governing automatic extensions of time for making certain elections. Section 301.9100-3 provides the standards the Commissioner will use to determine whether to grant an extension of time for regulatory elections that do not meet the requirements of § 301.9100-2.

Section 301.9100-3(a) provides that requests for relief subject to § 301.9100-3 will be granted when the taxpayer provides the evidence (including affidavits described in § 301.9100-3(e)) to establish to the satisfaction of the Commissioner that (1) the taxpayer acted reasonably and in good faith, and (2) the grant of relief will not prejudice the interests of the Government.

Conclusion

Based solely on the facts submitted and representations made, we conclude that Estate has satisfied the requirements of §§ 301.9100-1 and 301.9100-3. As a result, Estate is granted an extension of time of 120 days from the date of this letter to file an election under § 663(b). The election should be made by filing an income tax return for the year ending on Date 2, amended to include the election, with the appropriate service center. A copy of this letter should be attached to the amended return.

8. **Where Estate Tax Paid In Full, Late Return Not Cause For Penalty**. Skeba v. United States, 2020 WL 70962 (D. NJ. 2020) involved a situation where estate tax was overpaid but the actual estate tax return was not filed until June 30, 2015, past the extension date of September 10, 2014. The IRS asserted a penalty because the tax was paid eight days past the original due date but an extension of time to pay, until September 10, 2014, had also been granted. The opinion states:

> In the Court's view, the resolution of this matter hinges on an interpretation of a section of the IRS Code (26 C.F.R.§ 6651) called "Failure to file tax return or to pay tax." This provision has several sections, and each shall be addressed.
>
> Generally, § 6651 addresses the assessment of penalties for late filing of a return, and late payment of taxes due. More specifically, the penalty under § 6651(a)(1) addresses the failure to file a timely return:
>
> > In case of failure (1) to file any return on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount required to be shown as tax on such return 5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate ....
>
> 26 U.S.C. § 6651(a)(1).
>
> On the other hand, the penalty for failure to timely pay the tax is set forth in § 6651(a)(2). This section reads:

> In case of failure ... (2) to pay the amount shown as tax on any return specified in paragraph (1) on or before the date prescribed for payment of such tax (determined with regard to any extension of time for payment), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount shown as tax on such return 0.5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 0.5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate ...

§ 6651(a)(2).

The calculation of the penalty imposed for failure to timely file a return (subsection (a)(1)) and failure to timely pay the tax (subsection (a)(2)) is clarified in § 6651(b). It declares:

> (b) Penalty imposed on net amount due. For purposes of--
>
> > (1) subsection (a)(1), the amount of tax required to be shown on the return shall be reduced by the amount of any part of the tax which is paid on or before the date prescribed for payment of the tax and by the amount of any credit against the tax which may be claimed on the return,
> >
> > (2) subsection (a)(2), the amount of tax shown on the return shall, for purposes of computing the addition for any month, be reduced by the amount of any part of the tax which is paid on or before the beginning of such month and by the amount of any credit against the tax which may be claimed on the return[.]

§ 6651(b).

The parties disagree on how to construe these provisions. Plaintiff proffers two arguments in support of its position. First, Plaintiff argues that § 6651(a)(1) should be read together (*in pari materia*) with § 6651(b)(1). In reading these subsections together, Plaintiff concludes that the late filing penalty is calculated by using the formula set forth in subsection (a)(1), incorporating the "net amount due" on the "the date prescribed for payment" as set forth in subsection (b)(1). Since the estate tax was overpaid on March 18, 2014 and the extension ran until September 10, 2014, there was no net amount due on the September deadline; and hence, no penalty may be imposed.

Secondly, and in the alternative, Plaintiff argues that the phrase "such failure is due to reasonable cause not due to willful neglect" in subsection (a)(1) protects the taxpayer from a penalty if the return was filed late due to a reasonable cause.

The Government disagrees with the taxpayer's arguments. The Government proffers that the requirements of § 6651(a)(1) and (b) must be construed with another statute (26 U.S.C. § 6151) entitled "Time and place for paying taxes shown on returns." § 6151states: "[T]he date filed for payment of such tax shall be deemed a reference to the last day fixed for such payment (determined without regard to any extension of time for paying the tax)." More specifically, § 6151 reads in pertinent part:

> (a) General rule. Except as otherwise provided in this subchapter [26 USCS § 6151 *et seq.*] when a return of tax is required under this title or regulations, the person required to make such return shall, without assessment or notice and demand from the Secretary, pay such tax to the internal revenue officer with whom the return is filed, and shall pay such tax at the time and place fixed for filing the return (determined without regard to any extension of time for filing the return).
>
> * * *
>
> (c) Date fixed for payment of tax. In any case in which a tax is required to be paid on or before a certain date, or within a certain period, any reference in this title to the date fixed for payment of such tax shall be deemed a reference to the last day fixed for such payment (determined without regard to any extension of time for paying the tax).

Id. Based on § 6151, the Government cleverly reasons that the last day for payment was nine months after the death of Agnes **Skeba**—March 10, 2014; because no return was filed by that date a penalty may be assessed. Applying the rationale to the facts, the Government contends only $750,000 was paid on or before March 10, 2014, when $2,528,838 was due on that date. Referring back to § 6651(a)(1), a 25% penalty on the difference may therefore be assessed because it was not paid by March 10, 2014. As such, the full payment of the estate tax on March 18, 2014 is of no avail because the "last date fixed" was March 10, 2014. Accordingly, the Government argues that the imposition of a penalty in the amount of $450,959.00 is appropriate.

The IRS's arguments miss the mark. First, both §§ 6651(a)(1) and (a)(2) designate the specific day on which penalties will be assessed for both late filing and payment of the estate tax return. Both paragraphs specify that the "date prescribed" is to "be determined with regard to any extension of time for filing." The language of the statute in dispute is the one which is given precedence over a more generic statute like § 6151. *See La Vallee Northside Civic Asso. v. V.I. Coastal Zone Mgmt. Com.*, 866 F.2d 616, 621 (3d Cir. 1989); *see also Meyers v. Heffernan*, No. 12-2434 (MLC), 2014 WL 3343803, at *8 (D.N.J. July 8, 2014).

The Government puts forth a valid point that there is an administrative need to complete and close tax matters. Here, the Estate had nine months to file the return, the extension added six months, and Defendant unilaterally added another nine months to file the return. Although there was the timely payment of the estate taxes, the matter, in the Government's view, lingered and the administrative objective to timely close the file was not met. *See generally Boyle*, 469 U.S. at 251, 105 S.Ct. 687. There may be a need for some other penalty for failure to timely file a return, but Congress must enact same.

The opinion noted that the lawyer and CPA for the estate had been repeatedly assured that there would be no penalty, and then that the assessment was a mistake. The case shows the peril of relying on such assurances.

Rev. Rul. 81-237 appears to require always a minimum penalty of $100. There was no mention of that ruling in the opinion. The United States has appealed to the Third Circuit.

9. <u>Trustee of Revocable Trust Discharged From Personal Liability for Estate Tax</u>. The facts of <u>United States v. Paulson</u>, 2020 WL 1821022 (S.D. Cal. 2020), were simple:

> 6. On July 19, 2000, Mr. Allen E. Paulson died. (*Id.*)
>
> 7. Mr. Allen E. Paulson's Will was filed with the Probate Court. (*Id.*) Michael Paulson and Edward White were appointed and served as Co-Executors of the Estate until Edward White's resignation effective October 8, 2001. (*Id.*) Thereafter, Michael Paulson served as a court appointed Executor until January 15, 2013 and ceased performing those duties as part of the 2013 Settlement Agreement with the Co-Trustees. (*Id.*) The Court determined that because there was no executor appointed by the probate court after Michael Paulson's attempted resignation in 2013, Michael Paulson is still the statutory executor, but not personally liable for any estate tax in that capacity. (*Id.* at 3–4.)
>
> 8. At the time of Mr. Allen E. Paulson's death, the Living Trust held all of Mr. Allen E. Paulson's assets except for 100% of the shares in the Gold River Hotel & Casino Corporation (hereafter "Gold River shares"), which were valued at $0.[1] (*Id.* at 4.) The Living Trust's assets included real estate, stocks, bonds, cash, receivables and miscellaneous assets valued on the date of Mr. Allen E. Paulson's death at $193,434,344. (*Id.*) According to Form 706, the deductions[2] totaled $178,495,454. (*Id.*)
>
> 9. Following Mr. Allen E. Paulson's death, Michael Paulson and Edward White became co-trustees of the Living Trust until White's resignation effective October 8, 2001. (*Id.*)
>
> 10. On October 11, 2001, Nicholas V. Diaco, M.D. consented to act as co-trustee of the Living Trust with Michael Paulson. (*Id.*) Michael Paulson only served as trustee of the Living Trust until March 24, 2009, when he was removed. (*Id.*)
>
> 11. After an extension of time to file the return, on October 23, 2001, the IRS received the Estate's Form 706 Estate Tax Return. (*Id.* at 5.) The return was signed by Michael Paulson as Co-Executor. (*Id.*) The Estate paid $706,296 concurrently with its filing of the Estate Tax Return. (*Id.*) The Estate elected to defer the payment of the balance of its estate taxes under Section 6166 of the Internal Revenue Code over the next 15 years. (*Id.*) Although the original amount of estate tax shown due by the Estate Tax Return has been paid, the additional assessment of estate tax made by the IRS in 2006 remains unpaid. (*Id.*)
>
> 12. At the same time he filed the Estate Tax Return with the IRS, Michael Paulson filed a cover letter with the Return and also filed a letter dated October 19, 2001 requesting a discharge under 26 U.S.C. § 2204. (*Id.*)
>
> [emphasis added]

The issue was whether in the letter Paulson asked for discharge only as executor or as trustee too. The court found the request for discharge covered both:

> As Michael Paulson points out, in contrast to Plaintiff's arguments that none of the procedures were followed, the letter sent to the IRS tells a different story. First, the title of the letter is "Request for discharge of fiduciaries from personal liability." (Doc. No. 189-1 at 8.) The plural form of fiduciary may indicate that Michael Paulson sought to be discharged as a trustee and executor. Second, the letter enclosed (1) a copy of Federal Form 4768; (2) co-executor's Section 6166 election for deferral of federal estate tax; and (3) co-executor's request for discharge from personal liability pursuant to I.R.C. Section 2204. (Doc. No. 172

> at 21.) As to the request for discharge, the letter is not specific as to whether Michael Paulson was requesting discharge under parts (a) or (b) or both of Section 2204. (*Id.*) Further, requesting the longer time frame of nine months was likely appropriate as it encompassed both the time frame to be discharged as a fiduciary and as an executor.
>
> 226 U.S.C. § 2204 does not specify how Michael Paulson was to sign the letter. Plaintiff produces no case law to support its position that the way in which Michael Paulson signed the letter only exhibits that he signed it only as an executor. Michael Paulson argues that he signed using the term "Co-Executor" as a way to identify Michael Paulson's title in a manner consistent with his title appearing on the federal estate tax return. (Doc. No. 189-1 at 11.) Currently, there is no authority that requires specific format, form or wording to make an application for discharge. *See United States v. Johnson*, 224 F. Supp. 3d 1220, 1237 (D. Utah 2016) ("*Johnson II*"), *reversed on other grounds United States v. Johnson*, 920 F.3d 639 (10th Cir. 2019). However, Plaintiff argues that Michael Paulson signed various documents in different capacities and sometimes would sign the same document multiple times in his differing capacities. (Doc. No. 191-1 at 19–21.) There is no such requirement, however, how to sign the letter nor is there a requirement that Michael Paulson was supposed to provide two letters to the IRS.

The court appeared offended that the IRS took 12 years to raise the issue:

> Further, the IRS never contacted Michael Paulson regarding any confusion over the letter. In fact, the IRS never responded to the letter. The IRS is "to notify the fiduciary (1) of the amount of such tax for which it has been determined the fiduciary is liable, or (2) that it has been determined that the fiduciary is not liable for any such tax." 26 U.S.C. § 2204. If there was any confusion, Plaintiff argues that the IRS should have alerted the fiduciary that he remained liable for the full amount of "any estate tax for which the fiduciary may be personally liable." The Court agrees. Plaintiff should not have waited twelve years to raise this issue in litigation.

10. Reminder That Private Postage Meter Yields To Official Post Office Time Stamp. In Thomas v. Commissioner, T.C. Memo. 2020-33, the taxpayer's Tax Court petition was required to be filed by March 5, 2018 (90 days after the issuance of the Notice of Deficiency). The opinion states:

> Petitioners assert that petitioner husband took the petition to the Fernley [Nevada] USPS office on March 5, 2018, and placed it in the mailbox before 5 p.m., the last mail pickup time at that office. The Fernley USPS office, however, postmarked the envelope on March 6, 2018. Respondent speculates that the USPS office may have already been closed by the time petitioner husband placed the petition in the mailbox, which may be why the envelope was postmarked the day after the alleged mailing date. Respondent also notes that had petitioner husband taken the petition to the Reno USPS office the envelope would have been postmarked on that same day because that office postmarks mail pieces until 11:59 p.m.
>
> We follow the guidelines the regulations provide us. In this instance the regulations instruct us that where the envelope containing the petition bears a legible USPS postmark, the postmark must bear a date on or before the last date prescribed for filing for it to be considered timely filed. See sec. 301.7502 - 1(c)(1)(iii)(A), Proced. & Admin. Regs. Accordingly, even if we were to credit petitioners' assertions that they timely deposited the petition in the mail, the

> petition is still considered not timely filed because the USPS postmark on the envelope does not bear a date on or before March 5, 2018. See id. Further, because petitioners mailed the petition using postage printed through a private postage meter with no request that a certified mail receipt be postmarked by a USPS employee, they are not entitled to any relief under section 301.7502-1(c)(2), Proced. & Admin. Regs. Accordingly, the Court lacks jurisdiction under sections 6213(a) and 7502 to redetermine the deficiency, and we are obliged to grant respondent's motion to dismiss.

The administrative regulation is clear:

> Section 301.7502-1(c)(1)(iii)(B)(3), Proced. & Admin. Regs., provides for situations in which a mailpiece has both a USPS postmark and a non-USPS mark. That section provides as follows:
>
> If the envelope has a postmark made by the U.S. Postal Service in addition to a postmark not so made, the postmark that was not made by the U.S. Postal Service is disregarded, and whether the envelope was mailed in accordance with this paragraph (c)(1)(iii)(B) will be determined solely by applying the rule of paragraph (c)(1)(iii)(A) of this section.

11. Executor Personally Liable For Estate Tax. In United States v. Kohls, ______________________ (S.D. Ohio 2020) the executor didn't pay the estate tax owed, transferred the estate assets, and closed the estate. At issue was the statute of limitations on the IRS. The opinion states:

> Corwin J. Kohls died testate on September 10, 2001. On September 12, 2001, Douglas M. Kohls, his son, opened an estate in the Common Pleas Court of Montgomery County, Ohio, Probate Division ("Probate Court") and was named the executor.
>
> ***
>
> The IRS audit of the 706 Return was completed and, on or about May 27, 2005, the executor signed a Form 890, Waiver of Restriction on Assessment and Collection of Deficiency and Acceptance of Overassessment - Estate Gift and Generation Skipping Transfer Tax ("Assessment Waiver"). In the Assessment Waiver, the executor consented to the immediate assessment and the collection of a $199,077 estate tax deficiency. On that same date, the executor also signed a Form 4768, Application for Extension of Time to File a Return and/or Pay U.S. Estate (and Generation Skipping Transfer) -Taxes" ("Application for Extension"). Pursuant to 26 U.S.C. § 6161(b)(2). The IRS granted the Estate a one-year extension for payment so that the federal estate tax of $199,077, plus interest, was now due on or before May 27, 2006.
>
> Pursuant to 26 U.S.C. § 6203, on July 4, 2005, the IRS made an assessment against the Estate of the $199,077 estate tax deficiency. Doc. #7-2, PAGEID##49-50; Doc. #7-1, PAGEID#35.
>
> On August 12, 2005, and October 12, 2005, the Estate, through the executor, transferred two properties for no consideration. Specifically, on August 12, 2005, the Estate transferred property located at 8305-8311 Woodgrove Drive in Centerville, Ohio, ("Woodgrove Drive Property") to Defendant's sister, Cynthia L. Rogers. On October 12, 2005, property in the Estate located at 4627-4629 Far

Hills Avenue, Kettering, Ohio, ("Far Hills Avenue Property") was transferred to Defendant individually. Using the date of death values and subtracting the mortgages, the net equity of the Woodgrove Drive Property was $53,439 and the net equity of the Far Hills Avenue Property was $571,001. Doc. #7-1, PAGEID#37.

On May 27, 2006, the executor signed a second Application for Extension seeking another one-year extension to pay the Estate's taxes. This extension was also granted and payment of the tax deficiency was extended until May 27, 2007.

Although the federal tax deficiency was unpaid, the Estate was closed in February 2007. On May 27, 2007, the third and final Application for Extension was signed by the executor and granted by the IRS. As a result, payment of the Estate's tax and interest was due on May 27, 2008.

As of May 8, 2018, the amount of the Estate's federal estate tax liabilities, "taking into account the assessments of taxes, penalties and interest, and all payments, credits, abatements, and accruals" totaled $322,875.43. Doc. #7-5, PAGEID#166.

The IRS had 13 years to sue, but starting when?

In addition to the ten years to file suit, Defendant concedes that because of the three one-year extensions that were granted by the IRS in the Applications for Extension, Form 4768, 26 U.S.C. § 6161(b)(2) extends the ten-year statute of limitations for an additional three years. According to Defendant, because he signed the Assessment Waiver, also known as the Form 890, on May 27, 2005, the thirteen-year time period begins to run from this date. As such, the statute of limitations ran on May 27, 2018, and Defendant's Motion should be sustained. Doc. #8, PAGEID183.

Alternatively, Defendant argues that the latest period of time to start the running of the ten-year statute of limitations under 26 U.S.C. § 6502 is the date when the IRS received the signed May 27, 2005, Assessment Waiver. Defendant asserts that the IRS's date of receipt of the Assessment Waiver was June 2, 2005. Based on this argument, Defendant asserts that under § 6502(d) and the three one-year extensions, the "alternate collection statute expiration date" is June 2, 2018, which is thirty days before the Complaint was filed. Doc. #8, PAGEID#183.

In response to Defendant's statute of limitations defense, although Plaintiff agrees that it had 13 years to file its Complaint, it disputes that the May 27, 2005, Assessment Waiver is the starting point. Specifically, the United States argues that the "assessment" referred to in 26 U.S.C. § 6502 is not the Assessment Waiver Defendant signed on May 27, 2005. According to Plaintiff, "[A]n assessment is made 'by recording the liability of the taxpayer in the office of the Secretary in accordance with rules and regulations prescribed by the Secretary.'" 26 U.S.C. § 6203. *Laing v. United States*, 423 U.S. 161, 170 n.13 (1976) ("The assessment is essentially a bookkeeping notation that is made when the Secretary or his delegate establishes an account against the taxpayer on the tax rolls."). As such, Plaintiff argues that its Complaint was timely filed.

The Court finds that Defendant's reliance on the Assessment Waiver, Form 890, as the "assessment" referred to in 26 U.S.C. § 6502 is misplaced. A "Form 890 is a waiver of restriction on assessment and collection of the deficiency. It is not an assessment." *Singleton v. C.I.R.*, 71 T.C.M. (CCH) 3127, *3, n. 3 (T.C. 1996).

> An assessment is made by recording the liability of a taxpayer in the office of the Secretary in accordance with prescribed rules or regulations. Sec. 6203. The date of assessment is the date the summary record of assessment is signed by the assessment officer. Sec. 301.6203-1, Proced. & Admin.

Id.

T. MISCELLANEOUS

PART 4 – STATE DEVELOPMENTS

U. STATE DEVELOPMENTS

1. Access To Decedent's Email. Ajemian v. Yahoo!, Inc., 478 Mass. 169 (Ma. 2017) deals with an interesting issue of federal law and certain other collateral matters. The decedent died in 2006, intestate and without any documentation about his email. The decedent's siblings, as personal representatives, wanted the decedent's email from his Yahoo! account which Yahoo! refused to provide. The court discusses Yahoo!'s rationale as follows

> Yahoo contends that 18 U.S.C. § 2702(a) [the so-called Stored Communications Act] prohibits it from disclosing the contents of the e-mail account, while the personal representatives argue that they fall within two of the enumerated exceptions. The first of these, the so-called "agency exception," allows a service provider to disclose the contents of stored communications "to an addressee or intended recipient of such communication or an agent of such addressee or intended recipient." 18 U.S.C. § 2702(b)(1). The second, the "lawful consent" exception, allows disclosure "with the lawful consent of the originator or an addressee or intended recipient of such communication, or the [originator] in the case of remote computing service." 18 U.S.C. § 2702(b)(3). We address the applicability of each exception in turn.

The court determined that the personal representatives were not agents of the deceased:

> Under the common law, both as construed in the Commonwealth and more generally, an "agent" "act[s] on the principal's behalf and [is] subject to the principal's control." Restatement (Third) of Agency § 1.01 (2006). See Theos & Sons, Inc. v. Mack Trucks, Inc., 431 Mass. 736, 743, 729 N.E.2d 1113 (2000) ("An agency relationship is created when there is mutual consent, express or implied, that the agent is to act on behalf and for the benefit of the principal, and subject to the principal's control"). The decedent's personal representatives do not fall within the ambit of this common-law meaning; they were appointed by, and are subject to the control of, the Probate and Family Court, not the decedent.

[Citations omitted]

The personal Representatives had more luck with the lawful consent exception:

> We thus are confronted with the novel question whether lawful consent for purposes of access to stored communications properly is limited to actual consent, such that it would exclude a personal representative from consenting on a decedent's behalf. We conclude that interpreting lawful consent in such a manner would preclude personal representatives from accessing a decedent's stored

communications and thereby result in the preemption of State probate and common law. Absent clear congressional intent to preempt such law, however, there is a presumption against such an interpretation. See Egelhoff v. Egelhoff ex rel. Breiner, 532 U.S. 141, 151, 121 S.Ct. 1322, 149 L.Ed.2d 264 (2001) ("[R]espondents emphasize that the Washington statute involves both family law and probate law, areas of traditional [S]tate regulation. There is indeed a presumption against pre-emption in areas of traditional [S]tate regulation such as family law"); United States v. Texas, 507 U.S. 529, 534, 113 S.Ct. 1631, 123 L.Ed.2d 245 (1993) ("[s]tatutes which invade the common law ... are to be read with a presumption favoring the retention of long-established and familiar principles, except when a statutory purpose to the contrary is evident" [citation omitted]). The statutory language and legislative history of the lawful consent exception in the SCA do not evidence such a congressional intent.

***

At common law, a personal representative also may provide consent on a decedent's behalf to the waiver of a number of rights, including the attorney-client,[20] physician-patient,[21] and psychotherapist-patient privilege.[22] Under the Uniform Probate Code,[23] a personal representative may sell a decedent's property, Uniform Probate Code § 3–715(23); bring claims on the decedent's behalf, id. at § 3–715(22); and vote the decedent's stocks, id. at § 3–715(12). Thus, a construction of lawful consent that allows personal representatives to accede to the release of a decedent's stored communications accords with the broad authority of a lawfully appointed personal representative to act on behalf of a decedent.

Finally, had Congress intended lawful consent to mean only actual consent, it could have used language such as "actual consent" or "express consent" rather than "lawful consent." See, e.g., 18 U.S.C. § 2721(a)(2) (prohibiting State departments of motor vehicles from releasing personal information "without the express consent of the person to whom such information applies" [emphasis supplied]); Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 176, 114 S.Ct. 1439, 128 L.Ed.2d 119 (1994) (Congress knew how to provide for liability for aiding and abetting but chose not to do so); Pinter v. Dahl, 486 U.S. 622, 650, 108 S.Ct. 2063, 100 L.Ed.2d 658 (1988) ("When Congress wished to create [substantial factor liability for an offense], it had little trouble doing so"); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 734, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975) ("When Congress wished to provide a remedy to those who neither purchase nor sell securities, it had little trouble doing so expressly").

Accordingly, nothing in the language of the "lawful consent" exception evinces a clear congressional intent to preempt State probate and common law allowing personal representatives to provide consent on behalf of a decedent.

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Beyond Congress's overarching purpose in passing the SCA, the House committee report notes that "lawful consent" "need not take the form of a formal written document of consent." H.R. Rep. No. 647, 99th Cong., 2d Sess., at 66. Instead, such consent "might be inferred to have arisen from a course of dealing ...—e.g., where a history of transactions between the parties offers a basis for reasonable understanding that a consent to disclosure attaches to a particular class of communications." Id. Moreover, lawful consent could "flow from a user having had a reasonable basis for knowing that disclosure or use may be made with

> respect to a communication, and having taken action that evidences acquiescence to such disclosure or use—e.g. continued use of such an electronic communication system." Id.

Yahoo! also argued that the decedent signed a terms of service agreement that trumps everything. The court noted:

> The express language of the termination provision, if enforceable, thus purports to grant Yahoo the apparently unfettered right to deny access to the contents of the account and, if it so chooses, to destroy them rather than provide them to the personal representatives.
>
> Because the record before him was not adequate to establish the essentials of valid contract formation, the judge was unable to determine—even as an initial matter—whether the terms of service agreement could constitute an enforceable contract. The judge observed that Yahoo had not established that a "meeting of the minds" had occurred with respect to the terms of service, including whether they had been communicated to, and accepted by, the decedent. The judge accordingly denied Yahoo's motion for summary judgment on this alternative ground. We discern no error in this regard, and remand the matter for further proceedings.

A dissent would have ordered Yahoo! to turn over the emails immediately.

The Revised Uniform Fiduciary Access to Digital Assets Act deals with the lawful consent issue by requiring a decedent to give authority to a personal representative in a Will, and then providing various procedural steps (court order for example) before a service provider must provide emails. This Act has been adopted in 39 or more jurisdictions. The original version of the Act, which was opposed by the internet companies and proved unpassable, presumed consent. The policy argument was that we should not require people to have Wills. The providers reply was that we shouldn't run roughshod over contracts either.

Matter of Coleman, 63 Misc. 3d 609 (N.Y.S. Westchester 2019), involved access to an iPhone. Ryan Coleman died in his sleep at age 24; an autopsy was undeterminative. His parents wanted access to his iPhone. The decedent had no Will and had not used an on-line tool providing access. The court denied the request, granting access only to the "non-content" information. If the parents discovered a good reason they needed access to the content they could re-petition the court. The reasons offered at this stage were:

> (1) determine whether Ryan had any medical issues that his two younger siblings may also have; (2) determine whether any legal action on behalf of Ryan's estate may be appropriate; (3) identify and collect Ryan's digital and non-digital assets; and (4) marshal any of Ryan's digital assets as part of the estate administration. They also asked that the court make certain findings including that Ryan maintained an iCloud account associated with the Georgetown email address and that he owned a certain iPhone.

The Court summarized the prior New York case as follows:

In *Matter of White* (NYLJ, Oct. 3, 2017 at 25, col 1 [Sur Ct, Suffolk County 2017]), the fiduciary of the decedent's estate sought an order granting him access to the decedent's email account with Google, Inc. The fiduciary alleged that the decedent may have owned a business at the time of his death, and he needed access to the email account to confirm that this business existed to administer this potential asset for the estate.

In permitting access to the email account only to the extent of requiring Google to disclose the "contacts information stored and associated with the email account," the court noted the importance of balancing a fiduciary's duty to properly administer the estate with the possibility of the unintended consequences of disclosure of "sensitive or confidential data" regarding the decedent (*id.*). The court wrote "unfettered access to a decedent's digital assets may result in an unanticipated intrusion into the personal affairs of the decedent" that is unrelated to the reasons the content of the emails was sought (*id.*).

In *Matter of Serrano* (56 Misc 3d 497 [Sur Ct, NY County 2017]), the decedent's fiduciary requested access to his deceased spouse's Google email, contacts, and calendar information to "be able to inform friends of his passing" and "close any unfinished business." In limiting the permissible disclosure to the non-content contact list and calendar information associated with the decedent's account, the court, citing EPTL 13-A-3.2, stated that the record before the court indicated that this data was all that was "reasonably necessary for the administration of the estate" (*id.* at 499). The court held open the possibility of a renewed application in which the fiduciary showed how the content information was necessary to the estate administration.

In *Matter of Swezey* (NYLJ, Jan. 18, 2019 at 34, col 2 [Sur Ct, NY County 2019]), the fiduciary commenced an SCPA 2103 turnover proceeding against Apple seeking the decedent's photographs which were stored on iTunes and iCloud. There, the decedent did not use an online tool to provide direction for his digital assets and, although he died testate, he did not specifically provide for the disposition of his digital assets. In ordering Apple to disclose the photographs, the court relied on the facts that, in the decedent's last will and testament, he left his personalty and his residuary estate to his surviving spouse and that the decedent and his spouse "gave to each other implicit consent to access each other's digital assets" (*id.*). In doing so, the court quoted EPTL 1-2.15, noting that a decedent's property is "defined as 'anything that may be the subject of ownership,' real or personal" and that "include[s] assets kept in a digital form in cyberspace" (*id.*).

In re Scandalios, 2019 WL 266570 (N.Y. Sur. 2019) involved a 45-year old photographer who died with a wife and two minor children. The opinion states:

A Digital assets are "electronic record[s] in which an individual has a right or interest" (EPTL 13-A-1 [i]), which consist of electronic communications[3] and other digital assets that are not electronic communications. This distinction is significant in that disclosure of electronic communications, unlike disclosure of other digital assets, requires proof of a user's consent or a court order (EPTL 13-A-3.1; *see Matter of Serrano,* 56 Misc 3d 497 [Sur Ct, NY County 2017]).

Here, decedent's photographs stored in his Apple account are not "electronic communications," the disclosure of which, in the absence of a court order, requires consent of the account holder in any form listed under EPTL 13-A-2.2. Therefore, Apple is required to disclose the photographs stored in decedent's

> Apple account associated with his Apple ID identifiable by decedent's two email accounts as listed in the petition (EPTL 13-A-3.2).
>
> Accordingly, and in order to provide petitioner with the order that he seeks to satisfy Apple's request, the court makes findings and enters directions as follows (EPTL 13-A-3.2 [d][4]): (1) decedent was the user of an account with Apple, the ID for which is either of the two email accounts provided by petitioner, an individual with personal knowledge that decedent was the user of those email accounts; (2) petitioner is the fiduciary of decedent's estate; and (3) no lawful consent is required for disclosure of these photographs under the Stored Communications Act (18 USC §§ 2701 *et seq.* [part of the Electronic Communication Privacy Act of 1986]) or the New York Administration of Digital Assets law (EPTL Article 13-A) and, in fact, EPTL 13-A-3.2 mandates disclosure of such.
>
> Based on these findings, upon service of a copy of this decision and order, Apple shall afford petitioner the opportunity to reset the password to decedent's Apple ID.

The decedent's will did not provide for access to the decedent's digital assets.

2. **<u>Electronic Wills</u>**. <u>In re Estate of Horton</u>, 325 Mich. App. 325 (Mich. App. 2018), the court considered very sad, but simple facts:

> The decedent, Duane Francis Horton II, committed suicide in December 2015, at the age of 21. Before he committed suicide, decedent left an undated, handwritten, journal entry. There is no dispute that the journal entry was in decedent's handwriting. The journal entry stated:
>
>> I am truly sorry about this . . . My final note, my farewell is on my phone. The app should be open. If not look on evernote, "Last Note"[.]
>
> The journal entry also provided an email address and password for "evernote."
>
> The "farewell" or "last note" referred to in decedent's journal entry was a typed document that existed only in electronic form. Decedent's full name was typed at the end of the document. No portion of the document was in decedent's handwriting. The document contained apologies and personal sentiments directed to specific individuals, religious comments, requests relating to his funeral arrangements, and many self-deprecating comments. The document also contained one full paragraph regarding the distribution of decedent's property after his death:
>
>> Have my uncle go through my stuff, pick out the stuff that belonged to my dad and/or grandma, and take it. If there is something he doesn't want, feel free to keep it and do with it what you will. My guns (aside from the shotgun that belonged to my dad) are your's to do with what you will. Make sure my car goes to Jody if at all possible. If at all possible, make sure that my trust fund goes to my half-sister Shella, and only her. Not my mother. All of my other stuff is you're do whatever you want with. I do ask that anything you well, you give 10% of the money to the church, 50% to my sister Shella, and the remaining 40% is your's to do whatever you want with.

> In addition, in a paragraph addressed directly to decedent's uncle, the note contained the following statement: "Anything that I have that belonged to either Dad, or Grandma, is your's to claim and do whatever you want with. If there is anything that you don't want, please make sure Shane and Kara McLean get it." In a paragraph addressed to his half-sister, Shella, decedent also stated that "all" of his "money" was hers.

The decedent was under a guardianship and the guardian, Guardianship and Alternatives, Inc. (GAI), offered the Will for probate.

The opinion states:

> In this case, it is undisputed that decedent's typed, electronic note, which was unwitnessed and undated, does not meet either the formal requirements for a will under MCL 700.2502(1) or the requirements of a holographic will under MCL 700.2502(2). Instead, the validity of the will in this case turns on the applicability of MCL 700.2503 and whether the trial court erred by concluding that GAI presented clear and convincing evidence that decedent intended the electronic document to constitute his will.

The court quotes and discusses MCL 700.2503 as follows:

>> Although a document or writing added upon a document was not executed in compliance with section 2502, the document or writing is treated as if it had been executed in compliance with that section if the proponent of the document or writing establishes by clear and convincing evidence that the decedent intended the document or writing to constitute any of the following:
>>
>> (a) The decedent's will.
>>
>> (b) A partial or complete revocation of the decedent's will.
>>
>> (c) An addition to or an alteration of the decedent's will.
>>
>> (d) A partial or complete revival of the decedent's formerly revoked will or of a formerly revoked portion of the decedent's will.
>
> "The plain language of MCL 700.2503 establishes that it permits the probate of a will that does not meet the requirements of MCL 700.2502." *In re Estate of Attia*, 317 Mich App 705, 711; 895 NW2d 564 (2016). Indeed, other than requiring "a document or writing added upon a document," there are no particular formalities necessary to create a valid will under MCL 700.2503.2 Essentially, under MCL 700.2503, any document or writing can constitute a valid will provided that "the proponent of the document or writing establishes by clear and convincing evidence that the decedent intended the document or writing to constitute . . . [t]he decedent's will." MCL 700.2503(a). In considering the decedent's intent, "EPIC permits the admission of extrinsic evidence in order to determine whether the decedent intended a document to constitute his or her will." *In re Estate of Attia*, 317 Mich App at 709. See also MCL 700.2502(3).

The entire "electronic will" issue is controversial. Footnote 5 is interesting in that regard:

> 5 Jones argues that GAI did not present testimony that anyone saw decedent type the suicide note and that, because it was merely in electronic form, someone else could have typed or altered the suicide note. The trial court rejected Jones's argument that the document had been written or altered by someone other than decedent as mere speculation without supporting evidence. Jones does not dispute that the handwritten, journal entry was in decedent's handwriting. That journal entry directed its finder to decedent's cell phone. One of the individuals who found and read the electronic note on decedent's cell phone identified the contents of the note at the hearing. She indicated that she "know[s]" what the notes "says" and that she would "[a]bsolutely" recognize if the note had been changed. The probate court expressly found this witness's testimony to be credible. Deferring to the trial court assessment of credibility, *In re Estate of Erickson*, 202 Mich App 329, 331; 508 NW2d 181 (1993), the evidence shows that decedent wrote the electronic note and that it was not altered by anyone else. Contrary to Jones's arguments, the trial court did not clearly err by concluding that the electronic note was written by decedent.

The Michigan Supreme Court declined to hear the case.

The Uniform Law Commission has approved a uniform electronic wills act. The issues memo for the annual meeting discussion prior to approval states:

> This memo provides an introduction to and overview of the Uniform Electronic Wills Act, scheduled for its second and final reading at our 2019 Annual Meeting in Anchorage.
>
> **Background.** In this day and age of digitization, people assume that they can make and execute electronic wills. As a result, with increasing frequency, courts have been asked to validate wills written and "signed" on a tablet in front of witnesses, and unattested wills made in iPhone videos or notes files, or even one consisting of an unsent text message, signed with a smiley face emoji. Given that trillions of dollars of retirement assets pass by beneficiary designations that may be created and signed online, formal will signature and attestation requirements seem outdated and obsolete to many people, so these cases likely will become commonplace.
>
> Commercial providers and remote notary companies have seized on this opportunity. They would like to provide services that would allow people to execute their wills online, eliminating the use of paper and using witnesses and a notary provided by the company. Such companies have drafted and successfully introduced non-uniform legislation in several states which validates electronically signed wills, but also codifies the company's business model in the statutes. The Uniform Electronic Wills Act, instead, simply allows a testator to execute a will electronically, while maintaining protections for the testator that are available to those executing traditional wills (usually paper), and creates execution requirements that, if followed, will result in a valid "self-proving" will (one admitted without a court hearing to determine validity if no one contests the will).
>
> The Uniform Electronic Wills Act supplies sensible rules and policies for the execution and validity of wills signed electronically on a computer, instead of on paper. It is necessary because while bilateral commercial contracts may be validly signed electronically under the Uniform Electronic Transactions Act (UETA) § 7(a), wills are excluded from its scope under §3(b).

Key Policies. The Uniform Electronic Wills Act retains core wills act formalities of writing, signature and attestation, but adapts them. The will must exist in the electronic equivalent of text when it is electronically signed.

The electronic will must be signed in the physical presence of the requisite number of witnesses (normally, two), or, in states that allow it, in their virtual presence. We know that many states oppose attestation by remote (virtually present) witnesses, so the act is designed to make that form of attestation optional and can be easily enacted without that.

While the Uniform Probate Code's harmless error rule would allow courts to excuse many execution errors, it has been enacted in only eleven states. Given its renewed importance in the era of self-help will drafting, the harmless error rule is included in the Uniform Electronic Wills Act's Section 6.

The Electronic Wills Act provides that electronic wills, like traditional ones, can be revoked effectively with a revocation document or a subsequent will or codicil. Although it may prove harder to unambiguously revoke an electronic will by physical act, because there can be an infinite number of identical originals, a court will be responsible for determining the intent, which seems adequate protection. The Committee considered not permitting revocation by physical act but realized that many people would assume that they could revoke their wills by deleting them. A requirement that revocatory intent be proven by a preponderance of the evidence also avoids the anomaly of requiring more evidence of revocation than is required of proper execution and attestation.

Most traditional wills today are "self-proving", meaning that the witnesses have not only signed the will, they have also signed an affidavit before a notary public, swearing that the will was properly signed and witnessed. The contents of the self-proving affidavits vary from state to state; the Electronic Wills Act reflects the one in UPC § 2-504. Although the UPC and many non-UPC states permit the affidavit to be signed at any time after the will, the Electronic Wills Act requires that it be executed with an Electronic Will, because doing so means that the self-proving affidavit will be incorporated into the Electronic Will document, itself.

The choice of law and comity provisions of the Electronic Wills Act were perhaps the most discussed and debated ones. Some states object to the remote execution of Electronic Wills, for a number of reasons, perhaps the most common being predictions of abuse by bad actors seeking to take advantage of, or defraud, vulnerable testators. As a practical matter, some states will seek to enforce that "no remote wills" policy by amending their wills acts not only by prohibiting the remote execution of electronic wills in their state, but also by refusing to recognize those that were validly executed out of state, but presented for probate in such a "no remote wills" state.

The Electronic Wills Act, in Section 4, reflects the policy that an electronic will that is valid where the testator was physically located when it was signed should be given effect under that (signing) state's law. This is consistent with the current law applicable to traditional wills and prevents the intestacy of a testator who validly signs a will while living in a state that permits remote execution, but moves to or just happens to die in a state that prohibits them. This provision would not validate the remotely executed, Nevada will of a testator who signed it while living in a state (say, Connecticut) which prohibits remote execution, if the will is later offered for probate in Connecticut. It would, however, later require Connecticut to admit the will to probate if it was signed remotely while the testator lived in Nevada, which recognizes such wills.

3. **<u>Choice of Law Between Filial Support Statutes</u>**. An adult son was in a Pennsylvania care facility and his parents were in New Jersey in the case of Melmark v. Schutt, 206 A. 3d 1096 (Pa. 2019). The essence of the issue was set forth by the court as follows:

> Melmark suggests Pennsylvania's filial-support law should be applied instead of New Jersey's, given the Commonwealth's interest in ensuring that facilities which care for indigent persons in Pennsylvania are able to look to designated family members to obtain compensation for the provision of essential services. Melmark indicates this interest is especially pronounced here because Alex's "wealthy parents" "knowingly abandon[ed]" their indigent son "in Pennsylvania with no form of support." Brief for Appellant at 25, 31. Further, Melmark proffers that all relevant events occurred in Pennsylvania and, as a Pennsylvania non-profit institution, Melmark was entitled to rely on Pennsylvania law when it provided care to Alex. Thus, Melmark argues, even if New Jersey law would otherwise give more protection to Parents than Pennsylvania's filial support statute for actions occurring in New Jersey, Pennsylvania has a stronger interest in the matter under the present facts.
>
> Melmark also emphasizes that Parents could have moved Alex to a New Jersey facility, where NJ-DDD would have resumed paying for Alex's care and residence, or continued with their efforts to compel NJ-DDD to pay Melmark. Instead, Melmark argues, Parents took steps, including manipulating the legal systems of both states, to keep Alex in Pennsylvania. According to Melmark, Parents did this because they wanted Melmark to be Alex's lifelong home where he could live free of charge. Under this scenario, Melmark offers that Pennsylvania's policy favoring family-supplied compensation for the care of indigent persons should predominate. See *id*. at 30-42.
>
> Parents counter that New Jersey has the basic responsibility for establishing and regulating the support obligations of its citizens. They suggest that the choice-of-law question should be viewed as solely involving the relationships among family members. See Brief for Appellees at 19-22 (citing *McSwain v. McSwain*, 420 Pa. 86, 215 A.2d 677 (1966) (where an automobile accident involving Pennsylvania citizens occurred in Colorado, applying Pennsylvania law generally precluding interspousal lawsuits, although the suit would have been permitted under Colorado law)). Employing traditional choice-of-law factors, such as which state has the most significant contacts or relation to the action and the protection of justified expectations, Parents emphasize that Parents and Alex were New Jersey citizens at all times and that Parents reasonably expected to be relieved of any obligation to support Alex inasmuch as he was no longer a minor and they were over 55 years old. By contrast, Parents characterize Pennsylvania's interest in this litigation as less weighty as it solely involves the ability of a private institution to be paid for services rendered.
>
> Parents assert, as well, that requiring them to make support payments under Pennsylvania law, when New Jersey exempts its citizens over the age of 55 from such liability, would violate their equal protection rights. For support, they reference *Pennsylvania, Department of Public Assistance v. Mong*, 117 N.E.2d 32 (Ohio 1954), a dispute in which an indigent father living in Pennsylvania sought support from a son whom he had abandoned while the son was under 16 years old, and who was living in Ohio at the time of the litigation. Ohio's statute relieved the son of obligations toward his father due to the abandonment, whereas Pennsylvania's did not. The court applied Ohio law on the grounds that it would violate equal protection not to allow him to avail himself of Ohio's protections

> solely because the father was from Pennsylvania. Parents interpret Mong as indicating that the law of the state where the alleged obligor lives – here, New Jersey – should control. See Brief for Appellees at 26.

The court determined that Pennsylvania law should apply. The opinion states:

> We do not deny that New Jersey has a substantial competing interest in fulfilling its policy of exempting parents over 55 years old from support obligations relative to their adult children. In relation to this specific dispute, however, the force of that interest is diminished for two reasons. First, NJ-DDD took steps to ensure that Parents would not have to pay for Alex's support, as it offered to place Alex in a New Jersey facility at public expense. New Jersey thus acted pursuant to its public policy, and that policy could have been effectuated had Parents accepted NJ-DDD's offer.
>
> Second, and more important, the course of conduct in which Parents engaged would, by their admission, result in an unrelated private party (Melmark) bearing the cost of providing for their indigent son's care for the remainder of his life. In this respect, although New Jersey's welfare laws apparently provide for Alex's support at public expense, there is no reason to suppose that New Jersey has adopted a public policy favoring imposition of the ongoing cost of care for indigent adults on an *unwilling private third party*. By contrast, Pennsylvania plainly has a strong interest in ensuring that relatives do not leave their disabled family members at private Pennsylvania facilities in such a way that those facilities are forced to incur substantial uncompensated expenses on an indefinite basis – an interest which is reflected in 23 Pa.C.S. §4603. Under such a scenario, the exemption in New Jersey's statutory filial support law for parents over 55 years of age cannot justifiably override Pennsylvania's governing statute – at least for the period from April 1, 2012 to May 15, 2013 – so that the financial burden for Alex's care falls upon Melmark.
>
> In light of the foregoing, we conclude that Pennsylvania has the stronger interest in applying its law within the framework of this controversy. Accordingly, we will reverse the judgment of the Superior Court insofar as it directed to the contrary, and remand for application of Pennsylvania law as to Count III of the complaint.

4. Premarital Agreement A Fraudulent Transfer In Community Property State. In 2005, Robert Sturm got a judgment against Todd Moyer, who had no assets. Periodically, Strum investigated Moyer's assets. In 2014 Moyer married and signed a prenuptial agreement. The effect of the premarital agreement was at issue in Sturm v. Moyer, 32 Cal. App. 5th 299 (Ca. App. 2019). The opinion describes the agreement as follows:

> The premarital agreement provided that each party's earnings and income, and any property acquired during the marriage by each spouse, would be that spouse's separate property; each party acknowledged that these earnings, income, and property otherwise would be community property. The agreement attached as exhibits lists of each party's significant real and personal property and liabilities in which that party currently held an interest; Moyer's list (Exhibit A) included Sturm's judgment against him, as well as several liens and pending lawsuits. The agreement also included a kind of sunset provision (paragraph 5.15), which provided that in the event the judgments and liens against Moyer listed in Exhibit A, and any money judgment entered against him during marriage, lapse or otherwise become unenforceable for any reason, the parties' earnings and income,

> and any assets purchased with those earnings and income, from the date of the marriage will be treated as community property, with certain exceptions. Finally, the premarital agreement included a provision allowing the parties to open a jointly owned checking account to meet their reasonable present and future living expenses, but providing that any property acquired with funds from the account will be owned in the ratio of the respective contributions of each party's separate property into the account; it also expressly stated that the account will not create any community property interest.

The application of the Uniform Fraudulent Transfers Act (UFTA) was discussed as follows

> Having set forth the relevant statutory provisions, we consider whether the UFTA applies to premarital agreements (such as the one at issue here) that make each spouse's earnings, income, and other assets acquired during marriage that spouse's separate property. Resolution turns on two key questions. First, does such an agreement effect a "transfer" under the UFTA? Second, was the agreement intended to "hinder, delay, or defraud any creditor" of the debtor-spouse? The first question is one of law, and can be resolved in this appeal from a demurrer judgment. The second question is one of fact, which cannot be determined on a demurrer or an appeal from a demurrer. We simply note that the complaint alleges sufficient facts to meet the requirement of fraudulent intent, but proof of those facts awaits trial.
>
> Considering the first question, as noted, "transfer" under the UFTA has a broad meaning. It includes "every mode, direct or indirect, absolute or conditional, . . . of disposing of or parting with an asset or an interest in an asset." (Civ. Code, former § 3439.01, subd. (i); currently, Civ. Code, § 3439.01, subd. (m).) Under this definition, there is no doubt that an agreement made *during marriage* in which a debtor-spouse agrees that the non-debtor-spouse's future earnings, income, or assets would be the non-debtor-spouse's separate property constitutes a transfer because the debtor-spouse is parting with an interest in an asset — the community property represented by the other spouse's earnings — in which he or she has a "present [and] existing . . . interest[]" (Fam. Code, § 751) during continuance of the marriage. (See *State Bd. of Equalization v. Woo* (2000) 82 Cal.App.4th 481.)
>
> But what if this same agreement is made in a premarital agreement? Because the parties are not married when the agreement is entered into, the debtor-spouse has no present and existing interest in the community property represented by the non-debtor-spouse's future earnings, income, and assets. Thus, it can be argued (as defendants do here) that no transfer takes place because, by the premarital agreement, the spouses altered the applicability of the community property laws such that neither spouse obtains any interest in community property upon marriage. On the other hand, it can be argued (as Sturm does here) that by law the premarital agreement does not become effective until marriage (Fam. Code, § 1613), at which point two things happen — each spouse obtains a present interest in community property by operation of law (Fam. Code, § 751) and then, by agreement, each spouse transfers to the other his or her community interest in the other's earnings, income, or other property acquired during the marriage.
>
> ***
>
> It might be argued that applying the UFTA to a premarital agreement in which the parties agree that each party's earnings, income, and assets acquired during marriage would be that party's separate property would discourage marriage in cases, such as the present one, in which one of the parties has significant debts

> while the other party has substantial income. But the Legislature already has provided protection for the couple in such a case, by enacting Family Code section 911. As noted, under that statute, the non-debtor-spouse's earnings are sheltered from liability for the debtor-spouse's premarital debts, so long as those earnings are kept by the non-debtor-spouse in a separate account (to which the debtor-spouse does not have a right of withdrawal) and are not commingled with other property in the community estate. This provision demonstrates, not only an intent to protect the non-debtor-spouse's earnings, but also a policy judgment — an intent to prevent the debtor-spouse from taking advantage of that protection at the expense of his or her creditors by being allowed access to the protected funds.

5. **Child Support vs. Special Needs**. Alexander v. Harris, 2019 WL 2147281 (Fl. App. 2019) dealt with a fascinating policy issue. A father was the beneficiary of a special needs trust established when he was injured in a car accident. He owed about $92,000 in child support. The special needs trust received more monthly than the father's expenses and thus had accumulated about $142,000. Could the $92,000 be paid from the trust. The court held yes stating:

> The father argues that using the trust's funds to satisfy his support obligations would jeopardize his eligibility for public assistance under federal law; however, he cannot identify any legal basis for this conclusion. We can find no federal law or regulation expressly addressing the garnishment of a special needs trust to satisfy a support obligation. To the extent that 42 U.S.C. § 1396p discusses support payments and eligibility, subsection (c)(2)(B)(iii) states that "[a]n individual shall not be ineligible for medical assistance by reason of paragraph (1) to the extent that . . . the assets . . . were transferred to . . . the individual's child." Furthermore, federal law gives great deference to state courts in family law proceedings, and the Supreme Court has explained that "[s]tate family and family-property law must do 'major damage' to 'clear and substantial' federal interests before the Supremacy Clause will demand that state law be overridden." *Hisquierdo v. Hisquierdo*, 439 U.S. 572, 581 (1979) (quoting *United States v. Yazell*, 382 U.S. 341, 352 (1966)). In *Rose v. Rose*, 481 U.S. 619, 630 (1987), the Supreme Court recognized that payment of child support is in the parent's best interest, explaining that federal "benefits are not provided to support [the beneficiary] alone." There is no indication in the federal statutes that Congress has expressed any intention to preempt state statutes, like section 736.0503, that permit garnishment of spendthrift trusts to satisfy the child support obligations of the beneficiary. Id. at 628 ("Given the traditional authority of state courts over the issue of child support, their unparalleled familiarity with local economic factors affecting divorced parents and children, and their experience in applying state statutes . . . that do contain detailed support guidelines and established procedures for allocating resources following divorce, we conclude that Congress would surely have been more explicit had it intended the Administrator's apportionment power to displace a state court's power to enforce an order of child support.").
>
> Resolution of this case requires consideration of the equities between these particular parties and resolution of competing public policies related to the enforceability of spendthrift provisions and the payment of support.
>
> > On the one hand, there is the long held policy of this state that recognizes the validity of spendthrift trusts. On the other hand, there is the even longer held policy of this state that requires a former spouse or a parent to pay alimony or child support in accordance with court orders.

> *Bacardi*, 463 So. 2d at 221. Where the two conflict, this court has held that Florida's public policy favoring enforcement of support orders takes precedence. *Berlinger*, 133 - 6 - So. 3d at 966 ("Florida has a public policy favoring spendthrift provisions in trusts and protecting a beneficiary's trust income; however it gives way to Florida's strong public policy favoring enforcement of alimony and support orders."). Thus, although the trial court correctly recognized the compelling equitable interests of the parties in this case, we must nevertheless reverse. The special needs trust does not protect the father from his legal obligation to support his child. A continuing writ of garnishment is appropriate in this case, and the court may limit the award to such relief as is appropriate under the circumstances. *See* § 736.0503(3).

6. **Land Not Owned By A Trust**. In Homan v. Estate of Homan, 121 N.E.3d 1104 (In. App. 2019), a revocable trust discussed a farm but the farm was neither deeded to the trust not listed on Schedule A as a trust asset. The opinion states:

> Initially, we note that, in addition to leaving Schedule "A" blank, Robert never executed a deed transferring the farm land to the trust. Paul asserts that this fact, alone, is enough to establish that the farm land is not trust property. He cites Indiana Code section 32-21-1-13, which provides that, generally, "a conveyance of land or of any interest in land shall be made by a deed that is: (1) written; and (2) subscribed, sealed, and acknowledged by the grantor (as defined in IC 32-17-1-1) or by the grantor's attorney." But as our Supreme Court has explained, " 'If the owner of property declares himself trustee of the property, a trust may be created without a transfer of title to the property.' " *Hinds v. McNair*, 235 Ind. 34, 52, 129 N.E.2d 553, 563-64 (1955) (quoting Restatement (First) of Trusts § 17 cmt. a (Am. Law Inst. 1935)); *see also Kesling v. Kesling*, 967 N.E.2d 66, 79 (Ind. Ct. App. 2012), *trans. denied*. In other words, while a separate deed could certainly provide clarity, a written trust instrument can satisfy the written-deed requirement. *See, e.g.,* Restatement (Third) of Trusts § 10 (Am. Law Inst. 2003); *Rose v. Waldrip*, 316 Ga.App. 812, 730 S.E.2d 529 (2012); *Ladd v. Ladd*, 323 S.W.3d 772 (Ky. Ct. App. 2010); *Estate of Heggstad*, 16 Cal. App. 4th 943, 20 Cal.Rptr.2d 433 (1993).
>
> The question we must address is whether the trust agreement was sufficient to make the farm land property of the trust. We hold that it was not. Indiana's Trust Code defines "trust property" as "property either placed in trust or purchased or otherwise acquired by the trustee for the trust regardless of whether the trust property is titled in the name of the trustee or the name of the trust." Ind. Code § 30-4-1-2(22). One way for property to be "placed in trust" is "a declaration by an owner of property that he or she holds that property as trustee for one or more persons[.]" Restatement (Third) of Trusts § 10. Here, the trust agreement includes the framework for such a declaration when it says, "The GRANTOR hereby transfers to himself as TRUSTEE the property listed on the attached schedule, marked Schedule 'A', and incorporated herein." However, because Schedule "A" was left blank, it cannot be said that Robert "declared" himself trustee of the farm land or any other property.
>
> John directs us to Indiana Code section 30-4-2-1(b), which provides, in part, that "no formal language is required to create a trust, but the terms of the trust must be sufficiently definite so that the trust property ... may be ascertained with reasonable certainty." John contends that, despite the blank Schedule "A", the property Robert "intended to be trust property can be 'ascertained with reasonable certainty' " because the farm land is discussed in the distribution section of the

> trust agreement. Appellant's Br. p. 27. He emphasizes the provision that he (as successor trustee) "will continue the farm operation, held in trust ...." Appellant's App. Vol. II p. 47. Judging by this language, it may be that Robert intended to place the farm land into the trust and simply neglected to complete Schedule "A." But in determining whether property meets the definition of "trust property" under Indiana Code section 30-4-1-2(22), the question is not whether the owner "intended" to place the property in trust but whether the property was, actually, "placed in trust." Here, neither the farm land nor any other property was "placed in trust."

7. **Suicide a Breach of Marital Settlement**. Timothy Woytas was divorced and agreed to maintain certain life insurance policies payable to his former wife and children. The policies contained a two year suicide exclusion. Mr. Woytas committed suicide within two years. The court held that he breached his settlement agreement. Because of the dollars involved, the remedy was to award all of the estate assets to the former spouse and children. Woytas v. Greenwood Tree Experts, Inc., 206 A.3d 386 (N.J. 2019).

8. **Spendthrift Clause Ensured Trust Was Solely Wife's**. In Amy Levitan v. Daniel J. Rosen, 2019 WL 1984750 (Ma. App. 2019), a discretionary trust over which the wife also had a 5% withdrawal right, was allocated entirely to the wife's share. The opinion states:

> Here, the wife's share of the trust vested upon the death of her father in 2007. However, as discussed above, the wife's entire share is governed by the trust's spendthrift provision. In ruling that the spendthrift-controlled portion of the wife's share was a mere expectancy rather than a marital asset under § 34, the trial judge emphasized the absence of an "ascertainable standard" guiding the trustee's exercise of discretion. See Pfannenstiehl, 475 Mass. at 113, 55 N.E.3d 933 (" 'ascertainable standard' ... limits the discretion of the trustee, who is obligated to make distributions with an eye toward maintaining the beneficiary's standard of living in existence at the time the trust was created").
>
> However, the mere fact that a trustee's discretion is "uncontrolled" (i.e., not governed by an ascertainable standard) does not necessarily preclude a trust's inclusion in the marital estate. See Davidson v. Davidson, 19 Mass. App. Ct. 364, 371-372, 474 N.E.2d 1137 (1985). Indeed, in Pfannenstiehl, supra at 113-115, 55 N.E.3d 933, the inquiry did not turn on whether the trust contained an ascertainable standard. Rather, the Supreme Judicial Court held that the husband's interest in a discretionary trust was a mere expectancy because the class of beneficiaries was open (rendering the husband's one-eleventh interest susceptible to future reduction), and the trust was clearly intended to benefit multiple generations. Id. Similarly, in D.L., 61 Mass. App. Ct. at 497, 811 N.E.2d 1013, we held that the husband's beneficial interest in a discretionary trust was not includable under § 34 because "payments from principal to the beneficiaries [were] to be made, if at all, in the 'uncontrolled' discretion of the trustees," "in the thirty-eight year history of the trust, there ha[d] never been a distribution of principal from the trust to the husband," and the trust "[wa]s generational in nature," designed to "benefit the long-term (not near term) needs of the beneficiaries" (which included "not only the husband but his issue and [their] spouses").
>
> Here, by contrast, the wife's share of the trust is not susceptible to reduction (as she is the sole beneficiary of her share presently held in trust), the beneficiary class is closed, and the "primary intent" of the trust is to provide for the wife rather

> than for subsequent generations. Accordingly, the wife's trust interest in this case is sufficiently distinguishable from those deemed mere expectancies in Pfannenstiehl and D.L. Moreover, though the independent trustee's discretion is not guided by an ascertainable standard, there is some degree of predictability built into the trust by virtue of the wife's annual right to withdraw five percent of the trust principal, albeit subject to the spendthrift provision.[11]
>
> We therefore conclude that the wife's trust interest may properly be considered an asset subject to equitable distribution under § 34. See S.L. v. R.L., 55 Mass. App. Ct. 880, 883-884 & n.10, 774 N.E.2d 1179 (2002) (wife's one-fifth remainder interests in four trusts were includable in marital estate, as remaindermen classes were fixed for those trusts); Comins v. Comins, 33 Mass. App. Ct. 28, 30, 595 N.E.2d 804 (1992) (wife's vested beneficial interest in discretionary trust with closed beneficiary class was includable in marital estate); Davidson, 19 Mass. App. Ct. at 371-372, 474 N.E.2d 1137 (husband's remainder interest in father's testamentary trust, which granted trustees "uncontrolled discretion" and contained spendthrift provision, was part of marital estate because husband's remainder interest was fixed at time of father's death, despite that value of interest was uncertain). See also Lauricella, 409 Mass. at 216-217, 565 N.E.2d 436 (husband's vested, one-half beneficial interest in trust was includable under § 34 as husband occupied two-family house owned by trust, beneficiary class was closed, and husband only had to outlive trust's natural termination date to receive share of trust property). Because the judge here did not include the wife's entire trust share in the marital estate when assigning property under § 34, the portion of the divorce judgment pertaining to property division must be vacated and remanded. Though the wife's share of the trust is includable in the marital estate, it may only be assigned to the wife in light of the spendthrift provision. Accordingly, the wife's trust share shall be distributed exclusively to the wife, and the distribution of the remaining marital assets is left to the judge's discretion after considering the relevant § 34 factors on remand. See Davidson, supra at 373, 474 N.E.2d 1137.

The amount of the 5% withdrawal right did count for child support calculation purposes.

9. Non-Charitable Pledge Could Be Enforced on Promissory Estoppel Theory. A country club sued an estate to enforce a pledge for golf course improvements. Because it wasn't a charity, the court would not find a contract but could apply promissory estoppel. In In re Estate of Ryan, 302 Neb. 821 (Neb. 2019), the opinion states:

> Typically, a promise to make a gift in the future is not legally enforceable. Long ago, this court recognized that a promise to make a gift in the future is ordinarily unenforceable, even when put in the form of a promissory note. But in charitable giving cases, courts frequently find such future promises to be enforceable as a pledge or subscription. "A 'subscription contract' or 'subscription,' as it is often called, is not a gift, but is a contract, oral or written, by which one engages to contribute a sum of money for a designated purpose, gratuitously, as in the case of subscribing to a charity."
>
> Here, Shadow Ridge sought to have the pledge agreement enforced as a contract. A contract requires an offer, acceptance, and consideration. The general rule is that a subscription to a charitable or other institution must be supported by a consideration in order to be a binding obligation. But an action on a note given to a church, college, or other like institution, upon the faith of which money has been expended or obligations incurred, generally cannot be successfully defended on the ground of lack of consideration. In such cases, although the note is characterized as a gift or donation, the expenditure of money or assumption of

> liability by the donee in reliance on the promise constitutes a valuable and sufficient consideration.
>
> ***
>
> We conclude that the absence of cases enforcing pledge agreements in favor of profitmaking entities is not mere happenstance. "[F]rom early times academies, colleges, missionary enterprises, churches, and other similar institutions for the public welfare, have been established and often maintained upon private donations and subscriptions." Some early cases advanced the view that "a subscription to charity was purely gratuitous,—a nudum pactum, not enforceable at law,—and performance was left to the conscience and honor of the subscriber." But many courts, including this court, began to enforce eleemosynary subscriptions. This change flowed from a commendable regard for public policy and a desire to give stability and security to institutions dependent on charitable gifts.
>
> ***
>
> Shadow Ridge alternatively alleged that its claim should be granted under a promissory estoppel theory. Recovery on a theory of promissory estoppel is based upon the principle that injustice can be avoided only by enforcement of a promise. Under the doctrine of promissory estoppel, a promise which the promisor should reasonably expect to induce action or forbearance is binding if injustice can be avoided only by enforcement of the promise.
>
> Under Nebraska law, the doctrine of promissory estoppel does not require that the promise giving rise to the cause of action must meet the requirements of an offer that would ripen into a contract if accepted by the promisee. Under this theory, the main focus is on reasonable reliance. And here, we are reviewing only a dismissal for failure to state a claim.

10. <u>Meaning of Charitable Beneficiary Being in Existence at Death</u>. In <u>Sibley v. Estate of Sibley</u>, 2019 WL 1461325 (Fla. App. 3d, 2019), a trust provided as follows:

>> All remaining trust estate to the Settlor's charitable foundation, the CURTISS F. SIBLEY CHARITABLE FOUNDATION. If the [Foundation] **<u>is no longer in existence upon the Settlor's death</u>**, then the Trustee shall distribute all of the remaining trust estate to the FELLOWSHIP HOUSE FOUNDATION of South Miami, Florida.
>
> (Emphasis added)

At the decedent's death, the Sibling Charitable Foundation had been administratively dissolved. Of course, as the court notes, an administration dissolution can be easily corrected. What effect does that have? The opinion states:

> Additionally, Charles contends that because the Foundation was reinstated ten months after it was administratively dissolved (and seven months after Curtiss' death), the trial court erred in not relating back the reinstatement to the date of the administrative dissolution, thereby treating the Foundation as if it had never been administratively dissolved. Charles relies for this proposition on section 607.1422, Florida Statutes (2011), which provides in pertinent part:

> (1) A corporation administratively dissolved under s. 607.1421 may apply to the Department of State for reinstatement at any time after the effective date of dissolution. The corporation must submit a reinstatement form prescribed and furnished by the Department of State or a current uniform business report signed by the registered agent and an officer or director and all fees then owed by the corporation, computed at the rate provided by law at the time the corporation applies for reinstatement.
>
> (2) If the Department of State determines that the application contains the information required by subsection (1) and that the information is correct, it shall reinstate the corporation.
>
> (3) <u>When the reinstatement is effective, it relates back to and takes effect as of the effective date of the administrative dissolution and the corporation resumes carrying on its business as if the administrative dissolution had never occurred.</u>

> (Emphasis added.)
>
> However, we hold that this statutory provision does not apply to the issue presented here: a determination of whether, at a fixed point in time (the date of Curtiss' death), the Foundation "was no longer in existence" as instructed by the Trust's time-certain testamentary provision.
>
> Were we to apply the relation-back provision of section 607.1422 to the instant circumstance, as urged by Charles, the administration of an estate might never achieve finality, because an administratively dissolved beneficiary might (at some unknown point in the future) be reinstated and seek application of the relation-back provision to establish its nunc pro tunc existence. As Fellowship House aptly noted in its brief: "To assume the ability to perpetually reinstate the Foundation by [Charles] (or anyone else for that matter) after the death of Curtiss renders meaningless the testamentary instruction, as the Foundation could, quite possibly, always be in existence as long [as] someone prospectively filed the necessary annual reports and paid the delinquent fees."

11. **<u>Domestic Partner Has No Rights in Alaska</u>**. A long-time unmarried domestic partner had no property rights as determined in <u>Matter of Estate of Hatten</u>, 440 P.3d 256 (Ak. 2019). The facts were straightforward:

> Jerry Hatten and Beverly Toland met in California in 1989. Hatten, who lived in Alaska, returned to California in 1992 and reconnected with Toland. According to Toland, Hatten asked her to leave her job, friends, and family behind to live with him in Kasilof. Hatten purportedly assured her that if she relocated "he would take care of [her]" and that she "wouldn't have to work." Toland agreed, and she moved into the house that she would occupy with Hatten for over 20 years.
>
> Hatten was a commercial fisherman and paid for most of the couple's shared expenses. Toland worked at various jobs, first at a grocery store, then at a cannery, and later as a bartender. She also saw to domestic chores, such as cooking and cleaning. According to Toland, neither she nor Hatten had any other romantic partners, there was never any period of physical separation between them, and they shared a bed until the final years of Hatten's life, when he was experiencing discomfort from various ailments and opted to sleep on the couch.

> Neither Toland nor Hatten wanted to formally marry; each had previous marriages ending in divorce. Hatten's and Toland's financial and legal affairs consequently were less intertwined than their shared daily life. They had two joint credit cards, but they maintained separate checking accounts. Most significantly, Hatten exclusively owned the house they lived in.
>
> Hatten built the house in 1978 and paid off the building loan shortly after Toland's arrival in Alaska. In 1998 he obtained a loan to purchase the leased land where he had built the house, and he subsequently paid off that loan around 2007. A 1998 appraisal valued the property at $ 190,800. Toland did not contribute to the loan payments nor was she listed on utility accounts, which Hatten paid. At no time did Hatten grant title to Toland. Hatten has two adult children from his previous marriage, a daughter and a son. Although Hatten's daughter had for some time lived outside his home, it remained a primary residence for his son, who is physically disabled.
>
> Toland gave Hatten a will kit five years before his death. Hatten suffered from chronic obstructive pulmonary disorder, and when he battled pneumonia in January 2013 his friends and family asked how he planned to take care of his estate and urged him to create a will. In February Hatten named Toland the sole beneficiary of his $ 194,000 Edward Jones IRA account. The beneficiary designation form lists Toland's relationship to Hatten as "Domestic Partner." A month later Hatten suffered a heart attack and died. He left no will.

Alaska case-law may allow the division of property when domestic partners break-up while living, using a partnership theory, but no such theory is applicable at death:

> Alaska has distinct property division schemes that apply depending on when a relationship ends. If a marriage ends during the lifetimes of the spouses, courts apply statutory marital property principles and equitably distribute the spouses' property. During the marriage, spouses do not gain a present property interest in marital property simply by virtue of their relationship; that interest vests only at divorce. If a domestic partnership ends during the lifetimes of the partners, no specific statutes control the distribution of partnership property. This court instead has formulated a common law analysis to distribute the partnership property according to the partners' shared intent. This partnership property interest, like a marital property interest, vests only at the dissolution of the partnership.
>
> If a relationship ends at the death of one member, Alaska's probate code comprehensively governs the rights of both surviving spouses and domestic partners. A surviving spouse takes all, or most, of a deceased spouse's intestate estate; a surviving spouse who is dissatisfied with a deceased spouse's will can choose to receive a statutory elective share of the deceased's augmented estate. A surviving domestic partner, in contrast, inherits none of a deceased partner's estate under the probate code. And, unlike in the case of an inter vivos separation, the probate code has provisions disposing of all of a deceased partner's estate, whether the partner died testate or intestate. There is no "gap" to fill with a common law scheme that would distribute the deceased partner's property according to the partners' shared intent. If the deceased partner did not provide for the surviving partner through a will, the surviving partner will not inherit the deceased's property as a testamentary matter.

The court refused to follow Washington law because it is a community property state:

> Toland argues that this court should follow the Washington Supreme Court's decision in *Olver v. Fowler* and apply the same property division scheme to all domestic partnership separations regardless of when they occur. She contends that, consistent with *Olver*, this court should hold that domestic partnership property interests vest when the partners have the requisite intent. But Toland ignores a key distinguishing feature — Washington is a community property state, and spouses acquire "a *present*, undivided interest in the couple's community property." Domestic partners in Washington acquire a similar interest "by analogy." It follows then that, at the death of one partner in Washington, the surviving partner is entitled to retain the property interests properly acquired during the parties' lifetimes — even if that property is titled in the deceased partner's name alone. In Alaska spouses and domestic partners do not gain a present property interest in separately titled property merely by virtue of their relationships. Their interests vest only at an inter vivos separation. If that separation never occurs during the spouses' or partners' lifetimes, the property interest never vests.

12. Interesting Remedy Applied By Oregon Court to Nevada Trust. In Matter of Testamentary Trust Created Under Will of King, 295 Or.App. 176 (2018), the Oregon Court applied the trust's choice of law clause in favor of Nevada. That was in question because the Trustee had powers as set forth under Minnesota law:

> The parties dispute, however, whether those provisions of Nevada law are applicable. At trial, Sandra contended that, because she resides in Oregon and many of the trust assets were located in Oregon, the court should apply Oregon law to evaluate the loans that she made to herself, Cameron, and the winery, while the children contended that the court should apply Nevada law. Two attorneys, including Schroeder, the attorney who drafted the will, testified about the effect of section 6.10. As relevant here, Schroeder testified that section "6.10 was inserted in the Will because the decedent was a resident of Nevada." Schroeder testified that he and his co-drafter had intended that Minnesota law—in the form of the list of powers of the trustee that was incorporated into the will—would apply to the powers granted to the trustee, but otherwise Nevada law was to apply. As the trial court summarized, "[u]ltimately, [Schroeder] conceded that not much thought had been given to the interplay between [sections] 6.2 and 6.10, but he didn't think it really mattered because the same fiduciary standards applied."
>
> The trial court concluded that "it is inescapable that, by the title and content of [section] 6.10, Nevada law was intended to apply to matters (*i.e.* questions) involving the administration of the trust." Because NRS 163.030 prohibits insider loans by the trustee, the court concluded that all of the loans at issue were statutory breaches of trust despite the broad powers that section 6.2 purported to grant to the trustee.
>
> In her first assignment of error, Sandra contends that the court erred in concluding that Nevada law applies to the determination whether the disputed loans were breaches of trust. To evaluate that argument, we consider the text of Article Six of the will, beginning with whether it is ambiguous. "When a trust instrument is fully integrated and is not ambiguous on its face, extrinsic evidence is not admissible to establish the grantor's intent." *Samuel v. King*, 186 Or.App. 684, 692, 64 P.3d 1206, *rev. den.*, 335 Or. 443, 70 P.3d 893 (2003). Whether a term in an agreement is ambiguous is a question of law. *Yogman v. Parrott*, 325 Or. 358, 361, 937 P.2d 1019 (1997). "An ambiguity is presented only when the language of the agreement is reasonably capable of more than one plausible interpretation." *Samuel*, 186 Or.App. at 692, 64 P.3d 1206.

> Section 6.10 of the will provides: "Nevada law to govern: The laws of the State of Nevada shall govern all questions which may arise with respect to the interpretation of this Will or the administration of any trust established hereunder." (Underscoring in original.) In Sandra's view, that text invokes Nevada law only as "a 'gap filler,' that is, to answer questions which the will does not." She further contends that the loans do not raise any question "with respect to * * * the administration" of the DFK trust because the terms of the trust "specifically authorized her to loan money to whomsoever she chose, including herself, family members or companies with which she had a relationship." Sandra cites the powers listed in the incorporated section of Minnesota law as further support for her position that the trust authorized the loans, but she does not advance any developed argument that Oregon or Minnesota law governs the operation of the trust.
>
> Sandra's argument that the choice-of-law provision operates only as a "gap filler" is untenable. It overlooks the fact that, although a settlor has considerable latitude to dictate how a trust will operate, the trust nevertheless operates within and has effect only to the extent that it complies with the trust law of some jurisdiction. *See, e.g.*, ORS 130.030 ("The meaning and effect of the terms of a trust are determined by: (1) The law of the state, country or other jurisdiction designated in the terms of the trust * * *; or (2) In the absence of a controlling designation in the terms of the trust, the law of the state, country or other jurisdiction having the most significant relationship to the matter at issue."). Each jurisdiction has default rules of construction and validity of trusts, and each has some limitations on the settlor's ability to dictate the terms of the trust. *See, e.g.*, ORS 130.020 (listing exceptions to general principle that the terms of the trust prevail); NRS 163.160 (similar). The terms of the trust have legal effect only to the extent that they comply with the rules of the chosen jurisdiction. *See generally* ORS 130.030 (providing rules to determine which jurisdiction's law controls "[t]he meaning and effect of the terms of a trust").
>
> In short, Sandra's argument that the trust has independent legal meaning separate and apart from the law of any jurisdiction, and that Nevada law operates only interstitially, misconceives the law. The trust's text, alone, cannot answer any questions except against the backdrop of the law of some jurisdiction. The trust must be governed by the law of a jurisdiction, and the DFK trust chooses Nevada. Thus, absent any further argument by Sandra, we conclude that, when section 6.10 says that Nevada law applies to "all questions which may arise with respect to * * * the administration of" the DFK trust, it means, unambiguously, that Nevada law governs the administration of the trust. *See* ORS 130.030(1) (giving effect to settlor's choice of law as expressed in the trust). As explained above, Nevada law prohibits insider loans by the trustee regardless of whether such loans are allowed by the terms of the trust. NRS 163.030 (2009) (no "noncorporate trustee [shall] lend funds to himself or to his relative, employer, employee, partner or other business associate"); NRS 163.160 ("[N]o act of the settlor relieves a trustee from the duties, restrictions and liabilities imposed upon the trustee by NRS 163.030[.]").

So, Sandra's loans as trustee were improper. May the court direct that her income interest in the trust be redirected to the aggrieved beneficiaries, even though the trust is a spendthrift trust? The court concluded that remedies for a trust beneficiary are different than remedies for an outside third party. The opinion states:

> Under Nevada law, a violation of NRS 163.010 to 163.200 by a trustee may be treated as a breach of trust. NRS 163.190 ("If a trustee violates any of the

provisions of NRS 163.010 to 163.200, inclusive, * * * any beneficiary, cotrustee or successor trustee may treat the violation as a breach of trust."). With respect to testamentary trusts, the probate court may compel "redress of a breach of trust," NRS 153.031(I)(m), using its "full equitable powers," *Diotallevi v. Sierra Dev. Co.*, 95 Nev. 164, 591 P.2d 270, 272 (1979) (probate court's "full equitable powers" include the power to apply a "practical and fair method" for protecting the interests of the trust beneficiaries).

Those equitable powers historically included the power to apply a breaching trustee-beneficiary's interest in the trust to compensate the trust and other beneficiaries for losses caused by the breach of trust. *Restatement of Trusts* § 257 (1935) ("If a trustee who is also one of the beneficiaries commits a breach of trust, the other beneficiaries are entitled to a charge upon his beneficial interest to secure their claims against him for the breach of trust."); *accord.* George Gleason Bogert, *Trusts and Trustees*, § 191 n. 47, 206-07 (1951); *Restatement (Second) of Trusts*, § 257 (1959); *Restatement (Third) of Trusts*, § 104 (2003). That principle applied with equal force to spendthrift trusts:

"*Spendthrift Trust.* The rule stated in this Section is applicable although the interest of the trustee-beneficiary is not transferable by him or subject to the claims of his creditors. Although his ordinary creditors cannot reach his interest under the trust and apply it to the satisfaction of their claims, his interest can be impounded for the benefit of the other beneficiaries of the trust to make good any liability which he incurs for breach of trust."

Restatement of Trusts, § 257 comment f (citation omitted); *see also Restatement (Second) of Trusts*, § 257 comment f (similar); *Restatement (Third) of Trusts*, § 104 comment h ("This rule applies even though the beneficiary's interest is subject to a spendthrift restraint." (Citation omitted.)).

The Nevada Supreme Court recently indicated its adherence to the *Restatement* approach when it stated that "surcharging [the breaching trustee-beneficiary's] interest" in the trust is an appropriate remedy for a breach of trust by a trustee-beneficiary. *Montoya v. Ahearn*, 426 P.3d 599, 603 (Nev. 2018). Thus, if the DFK trust were not a spendthrift trust, there is little question that the trial court could order that Sandra's income interest be applied as a remedy to compensate for her breaches. The remaining question is whether a different result is required because the DFK is a spendthrift trust subject to NRS 166.120. We conclude that it is not.

The text of the statute provides that "payments," "the income," and "the interest of the beneficiary" may not be directed away from the beneficiary by voluntary or involuntary acts, including court orders; rather "the whole of the trust estate and the income of the trust estate shall go to and be applied by the trustee solely for the benefit of the beneficiary, free, clear, and discharged of and from any and all obligations of the beneficiary whatsoever and of all responsibility therefor." NRS 166.120(2), (3). Although that text is worded broadly, it is written in terms of creditors and proceedings that are *external* to the affairs of the trust. Because breach-of-trust proceedings differ from all other types of proceedings in that they are internal to the trust and logically precede a trustee's determination of the beneficiaries' interests for distribution purposes, it is not clear that NRS 166.120 is intended to apply to them. For additional guidance, we "turn to other legitimate tools of statutory interpretation, including related statutes, relevant legislative history, and prior judicial interpretations of related or comparable statutes by [the Nevada Supreme Court] or other courts," *Andrews*, 412 P.3d at 40, as well as the common law, including the *Restatement (Second) of Trusts*, *see Brock*, 390 P.3d at 650.

As explained above, all three restatements of the law of trusts recognize that a spendthrift provision does not prevent application of the rule that a breaching trustee-beneficiary's interest can be applied to compensate other beneficiaries for losses incurred because of the breach of trust. *Restatement of Trusts* § 257 comment f; *Restatement (Second) of Trusts* § 257 comment f; *Restatement (Third) of Trusts* § 104 comment u. Moreover, since at least 1941, Nevada's law of testamentary trusts has incorporated the common law of trusts. *See* NRS 163.190; *Diotallevi*, 591 P.2d at 271. Given those circumstances, we conclude that the Nevada Legislature did not intend NRS 166.120 to prohibit a surcharge of the breaching trustee-beneficiary's interest as a remedy for that trustee-beneficiary's own breach of trust, and that the Nevada Supreme Court would not apply the provision that way. Rather, if the legislature had intended NRS 166.120 to abrogate the well-established common law rule of surcharge of the breaching trustee-beneficiary's interest, it would have said so explicitly.

The court noted that just down the road, a California court had relatively recently reached the same results:

> A California appellate court addressed the same question in a case where the trust itself, rather than a statute, contained text similar to the text of NRS 166.120. *Chatard v. Oveross*, 179 Cal.App.4th 1098, 1100-01, 101 Cal.Rptr.3d 883, 886 (2009), *rev. den.*, Feb. 10, 2010 (interpreting a trust instrument providing that "[t]he interest of any beneficiary in the principal or income of any trust created by this instrument shall not be subject to claims of his or her creditors, or others, or liable to attachment, execution or other process of law"). The court concluded that surcharge of the breaching trustee-beneficiary's interest was not prohibited, and explained as follows:
>
> "Reasonably construed, the language of the spendthrift provision here suggests protection against the claims of persons foreign to the trust—'creditors, or others'—who might use a writ of 'attachment, execution or other process of law' to satisfy a claim from a beneficiary's interest. The language does not reasonably refer to the claims of fellow beneficiaries relating to a breach of trust, which might be satisfied, in the exercise of the probate court's equitable power, by surcharging the interest of the trustee-beneficiary in the distribution of trust assets. In short, absent clear language to the contrary, we decline to read the spendthrift clause so as to permit the perverse result of depriving the court of its equitable power to surcharge the interest of dishonest trustee-beneficiary to compensate other beneficiaries for breaches of the trust."
>
> *Chatard*, 179 Cal.App.4th at 1107, 101 Cal.Rptr.3d at 890.

13. Words Matter. All the law in the world won't help if the trust doesn't say something that can be easily understood. If you want the trust to speak for itself, then make sure the trust doesn't mumble.

Suppose co-trustees are directed to pay "any obligations the Donor's spouse may incur in acquiring assisted living or nursing home care … ." What are the trustees obligated to pay: only the original costs of obtaining and moving into assisted living, or the regular, on-going monthly costs of assisted living?

The Supreme Court of North Dakota determined this language was ambiguous and directed the lower court to "make findings on the evidence" of the settlor's intent in using this language in In the Trust of Roger S. Linn Restated Trust Agreement, 923 N.W.2d 815(N.D. 2019). The Donor's spouse was already receiving regular monthly income distributions from the trust, so the question was whether extra amounts should be distributed.

14. Words Matter II. In Famiglio v. Famiglio, 2019 WL 2063578 (Fl. App. 2d Dist. 2019), the prenuptial agreement distinguished between amounts of money due from husband to wife based on whether a petition for dissolution had been filed at certain times. The Court explains what happened:

> As it happened, two different petitions were filed in two different years.
>
> On March 25, 2013, the Wife filed a petition for dissolution of marriage in the Sarasota County Circuit Court. At that time, the parties would have been married for seven full years under the Prenuptial Agreement. That petition was never served, however, and on September 13, 2013, the Wife voluntarily dismissed the petition without prejudice.

> On May 26, 2016, the Wife filed a second petition for dissolution of marriage in the Sarasota County Circuit Court. By this time, the parties had been married ten full years for purposes of section 5.3 of the Prenuptial Agreement. The litigation pertaining to this second petition remains pending.
>
> The Husband then filed the underlying action for declaratory relief, seeking the court's construction of various provisions in the parties' Prenuptial Agreement.2 Relevant to this appeal, the Husband maintained that the Wife's filing of the first petition in 2013 became the operative year of measurement for purposes of section 5.3, so that she would be entitled to a payment of $2.7 million. The Wife argued that her second petition, the one that would result in an actual dissolution of the parties' marriage, controlled the operation of section 5.3. According to the Wife, she should receive $4.2 million under this provision of the Prenuptial Agreement.

The trail court found for the wife on the issue of when a petition was filed. The Court of Appeals reversed. The opinion states:

> We can only rely on the natural meaning of the phrase: "at the time a Petition for Dissolution of Marriage is filed." See In re Guardianship of Sapp, 868 So. 2d 687, 691 (Fla. 2d DCA 2004) ("Words and phrases should be given their natural meaning or a meaning most commonly understood in relation to the subject matter and circumstances."); J.N. Laliotis Eng'g Constr., Inc. v. Mastor, 558 So. 2d 67, 68 (Fla. 2d DCA 1990) ("Words used in an agreement should be given 'a natural meaning or the meaning most commonly understood in relation to the subject matter and circumstances.' " (quoting Granados Quinones v. Swiss Bank Corp., 509 So. 2d 273, 275 (Fla. 1987))). As we observed at the outset, it seems clear that the intent of this discrete provision is to link the lump sum alimony measurement to a singular occurrence—when a petition is filed with a court. Cf. The American Heritage Dictionary of the English Language 8057 (3d ed. 2000) ("when . . . *conj*. 1. At the time that"). In common parlance, predicating a condition on "when something occurs" or "at the time something occurs," is normally understood to mean the first time that the something occurs. This is so because conditional statements such as these are made with a view towards the future, as a way of indicating that a consequent condition will arise from a future condition's occurrence. And since the future cannot be known (except in hindsight), we would ordinarily read a provision like section 5.3.a. to align with the way we experience the passing of temporal events; that is, we would consider the future condition's first occurrence to be the operative one, even if it is a condition that might be capable of repetition. Thus, a golf course's rule, "when a thunderstorm approaches, you must end your golf game," would be universally understood to mean the first time a thunderstorm approaches. Certainly, more than one storm might come and go throughout the day, but the rule would make little sense if it were construed to mean whichever storm the golfer chooses, so long as the game is ended.
>
> That is how section 5.3.a. must be understood. Its natural meaning and frame of reference is to tie, prospectively, a variable sum of alimony on the singular occurrence of the filing of "a petition" for dissolution of marriage, which, in its most usual sense, would mean the first time such a petition is filed. In this case, that occurred on March 25, 2013.

15. **<u>South Dakota Refuses To Enforce California Child Support Order</u>**. In <u>Matter Cleopatra Cameron Gift Trust, Dated May 26, 1998</u>, 931 N.W.2d 244 (SD. 2019), the South Dakota Supreme Court held that a California order directing a trustee to pay child support for a beneficiary's children was not entitled to full faith and credit in South Dakota because it was a method of enforcement only. The opinion states:

> The Full Faith and Credit Clause of the United States Constitution provides that, "Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State." U.S. Const. art. IV, § 1. The command to afford the judgments of foreign states full faith and credit is further codified at 28 U.S.C. § 1738 (2013), which provides that authenticated records and judicial proceedings "shall have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State[.]"
>
> The United States Supreme Court has recognized that providing full faith and credit to the judgments of foreign states serves the salutary purpose of limiting the opportunity to relitigate issues that have been resolved previously through the judicial process. *Riley v. New York Trust Co.*, 315 U.S. 343, 348-49, 62 S. Ct. 608, 612, 86 L. Ed. 885 (1942). As a result, the Full Faith and Credit Clause "alter[s] the status of the several states as independent foreign sovereignties, each free to ignore obligations created under the laws or by the judicial proceedings of the others, and ... make[s] them integral parts of a single nation." *V.L. v. E.L.*, ––– U.S. ––––, 136 S. Ct. 1017, 1020, 194 L. Ed. 2d 92 (2016) (per curiam) (quoting *Milwaukee County v. M.E. White Co.*, 296 U.S. 268, 277, 56 S. Ct. 229, 234, 80 L. Ed. 220 (1935)); *see also Wooster v. Wooster*, 399 N.W.2d 330, 334 (S.D. 1987) (recognizing that valid foreign judgments are given effect in the interests of comity).
>
> Generally, if the judgment was "rendered by a court with adjudicatory authority over the subject matter and persons governed by the judgment, [it] qualifies for recognition throughout the land." *Id.* Furthermore, "[a] State may not disregard the judgment of a sister State because it disagrees with the reasoning underlying the judgment or deems it to be wrong on the merits." *Id.*; *see also Milliken v. Meyer*, 311 U.S. 457, 462, 61 S. Ct. 339, 342, 85 L. Ed. 278 (1940) ("[T]he full faith and credit clause of the Constitution precludes any inquiry into the merits of the cause of action, the logic or consistency of the decision, or the validity of the legal principles on which the judgment is based.").
>
> There are, however, certain limitations upon the requirements of the Full Faith and Credit Clause. Providing full faith and credit to a foreign state's judgment "does not mean that States must adopt the practices of other States regarding the time, manner, and mechanisms for enforcing judgments. Enforcement measures do not travel with the sister state judgment as preclusive effects do; such measures remain subject to the evenhanded control of forum law." *Baker by Thomas v. Gen. Motors Corp.*, 522 U.S. 222, 235, 118 S. Ct. 657, 665, 139 L. Ed. 2d 580 (1998); *see also* Restatement (Second) of Conflict of Laws § 99 (1971) ("The local law of the forum determines the methods by which a judgment of another state is enforced."). " 'Evenhanded' means only that the state executes a sister state judgment in the same way that it would execute judgments in the forum court." *Adar v. Smith*, 639 F.3d 146, 159 (5th Cir. 2011).
>
> Justice Scalia, in his concurring opinion in *Baker*, noted that the power of the Full Faith and Credit Clause is to make the judgment of "one State[ ] conclusive evidence in the courts of another State[.]" 522 U.S. at 242, 118 S. Ct. at 668

(Scalia, J. concurring) (quoting *Wisconsin v. Pelican Ins. Co.*, 127 U.S. 265, 291-92, 8 S. Ct. 1370, 1375, 32 L. Ed. 239 (1888)). Yet despite the preclusive power of one state's judgment, it "can only be executed in [the forum state] as its laws may permit." *Id.* (quoting *Lynde v. Lynde*, 181 U.S. 183, 187, 21 S. Ct. 555, 556, 45 L. Ed. 810 (1901)); *see also Adar*, 639 F.3d at 161 (holding there was no violation of the Full Faith and Credit Clause where a Louisiana registrar recognized the validity of a New York adoption decree, but only allowed one unmarried parent's name on the Louisiana birth certificate because under Louisiana law, only married couples could jointly adopt).

Here, an examination of the statute upon which the family court relied to order direct Trust payments to Christopher reveals it to be a conspicuous method of enforcing a support obligation where an obligor is the beneficiary of a trust protected by a spendthrift provision:

(c) Whether or not the beneficiary has the right under the trust to compel the trustee to pay income or principal or both to or for the benefit of the beneficiary, the court may, to the extent that the court determines it is equitable and reasonable under the circumstances of the particular case, *order the trustee to satisfy all or part of the support judgment* out of all or part of future payments that the trustee, pursuant to the exercise of the trustee's discretion, determines to make to or for the benefit of the beneficiary.

(d) This section applies to a support judgment notwithstanding any provision in the trust instrument.

Cal. Prob. Code § 15305 (emphasis added.)

It is equally clear that the *Ventura County* court also perceived Cal. Prob. Code § 15305 to be an enforcement provision. The *Ventura County* court broadened the enforcement authority of California trial courts to order direct trust payments, notwithstanding a spendthrift provision, upon a finding the trustee acted in bad faith by not authorizing a distribution. The court described Cal. Prob. Code § 15305 as a means of enforcing the support order, observing, "A spendthrift provision 'is not effective to exempt the trust from *enforcement of a judgment for support of a minor child* ....' " *Ventura Cty.*, 11 Cal. Rptr. 3d at 495 (emphasis added) (quoting Cal. Prob. Code § 15305, cmt.).

Viewed in this context, the family court's order compelling the direct payment of child support from the Trust was an unmistakable means of enforcing Cleopatra's obligation. Christopher's counsel acknowledged at oral argument that the direct payment order was, in truth, an enforcement method. In our view, the trustee was not the child support obligor and was only nominally joined in the divorce action to enforce Cleopatra's obligation. Because the means of enforcing judgments does not implicate full faith and credit considerations, the circuit court here was not required to submit to the California order compelling direct payments from the Trust if this method of self-executing enforcement is not authorized by South Dakota law. Based upon a review of our relevant statutes, it is not authorized and is, in fact, expressly prohibited.

Our Legislature has placed formidable barriers between creditor claims and trust funds protected by a spendthrift provision. *See* SDCL 55-1-41 ("If the trust contains a spendthrift provision, no creditor may reach present or future mandatory distributions from the trust at the trust level."); SDCL 55-1-35 ("No trustee is liable to any creditor for paying the expenses of a spendthrift trust."). More to the point, the Legislature has emphatically rejected even the specter of

> an argument that would allow a child support creditor to reach trust funds protected by a spendthrift provision. Indeed, this precise legal theory is identified in § 59 of the Restatement (Third) Trusts (2003) which states that "[t]he interest of a beneficiary in a valid spendthrift trust can be reached in satisfaction of an enforceable claim against the beneficiary for ... support of a child ...." However, the Legislature anticipated such an argument in South Dakota courts and definitively foreclosed it with its 2007 enactment of SDCL 55-1-25 which provides in part:
>
> In the area of creditor rights, the Restatement of Trusts (Third) and the Uniform Trust Code create many new positions of law as well as adopts many minority positions of law. The provisions of §§ 55-1-24 to 55-1-43, inclusive, affirmatively reject many of these positions. *Therefore, the Legislature does not intend the courts to consult the Restatement (Third) of the Law of Trusts ... § 59 ... with respect to subject matters addressed by the provisions of §§ 55-1-24 to 55-1-43, inclusive.*
>
> (Emphasis added); *see also Richardson v. Richardson*, 2017 S.D. 92, ¶ 16, 906 N.W.2d 369, 374 (stating that courts "must be mindful of the Legislature's public policy determinations ....").

The trust had been subject to various courts in California during the divorce of a beneficiary, Cleopatra. Cleopatra was at that time a co-trustee with a corporate fiduciary. Ultimately Cleopatra changed situs to South Dakota, with positive results (assuming she didn't want to pay continuing child support).

16. **South Carolina Supreme Court Abolishes Common Law Marriage**. The South Carolina Supreme Court abolished common law marriage in Stone v. Thompson, 2019 WL 3310480 (SC 2019), but did so only prospectively. It's reasoning is instructive and follows a national trend. The opinion states:

> Common-law marriage in South Carolina rests upon moral paternalism, as our courts have long recognized. *Id*. at 166-67, 177 S.E.2d at 539 ("The law presumes morality, and not immorality; marriage, and not concubinage; legitimacy, and not bastardy." (quotation omitted)). While our legislature has not expressly codified common-law marriage, it has recognized the institution by exception to the general requirement to obtain a marriage license. S.C. Code Ann. § 20-1-360 (2014).
>
> b. *The Modern Trend*
>
> The prevailing trend, however, has been repudiation of the doctrine. The reasons have been myriad—from economic to social—including some more nefarious than others. Bowman, *supra*, at 731-49. Alabama became the most recent state to do so, enacting Ala. Code 1975 § 30-1-20 in 2016. *See Blalock v. Sutphin*, ––– So. 3d ––––, ––––, 2018 WL 5306884 at *5 (Ala. 2018). By our count, this leaves fewer than ten jurisdictions that currently recognize the institution.[2]
>
> In 2003, the Pennsylvania Commonwealth Court set forth a thorough explanation for its conclusion that common-law marriage should no longer be recognized in *PNC Bank Corp. v. W.C.A.B. (Stamos)*, 831 A.2d 1269 (Pa. Commw. Ct. 2003).[3] Notably, the court determined:

> The circumstances creating a need for the doctrine are not present in today's society. A woman without dependent children is no longer thought to pose a danger of burdening the state with her support and maintenance simply because she is single, and the right of a single parent to obtain child support is no longer dependent upon his or her marital status. Similarly, the marital status of parents no longer determines the inheritance rights of their children. Access to both civil and religious authorities for a ceremonial marriage is readily available in even the most rural areas of the Commonwealth. The cost is minimal, and the process simple and relatively expedient.

831 A.2d at 1279 (internal citations omitted). The court also pointed to benefits of standardized formal marriage requirements such as predictability, judicial economy, and upholding the statutes' "salutary" purposes. *Id.* at 1279-81.

***

We find the Pennsylvania court's reasoning and other considerations sufficiently persuasive to adopt a bright-line rule requiring those who wish to be married in South Carolina to obtain a lawful license. Our law contains similar provisions regarding child support, inheritance, and the ceremonial marriage process. *See* S.C. Code Ann. §§ 20-1-210 to -240 (1976); §§ 62-2-101 to -109 (1976 & Supp. 2018); § 63-5-20 (1976 & Supp. 2018). The paternalistic motivations underlying common-law marriage no longer outweigh the offenses to public policy the doctrine engenders. By and large, society no longer conditions acceptance upon marital status or legitimacy of children. The current case is emblematic of this shift, as the parties' community of friends was wholly unconcerned with their marital status, and indeed several of their witnesses were in similar relationships. Meanwhile, courts struggle mightily to determine if and when parties expressed the requisite intent to be married, which is entirely understandable given its subjective and circumstantial nature. The solemn institution of marriage is thereby reduced to a guessing game with significant ramifications for the individuals involved, as well as any third party dealing with them.

Critically, non-marital cohabitation is exceedingly common and continues to increase among Americans of all age groups.[4] The right to marry is a fundamental constitutional right, *Obergefell v. Hodges*, —— U.S. ——, 135 S. Ct. 2584, 2604-05, 192 L.Ed.2d 609 (2015), which leads us to believe the right to remain unmarried is equally weighty, particularly when combined with our admonitions that a person cannot enter into such a union accidentally or unwittingly, *Callen v. Callen*, 365 S.C. 618, 626, 620 S.E.2d 59, 63 (2005). Further, we must agree with the many observers who have noted that common-law marriage requirements are a mystery to most.[5] The present case is again illustrative. None of the multiple witnesses who were asked understood what was required to constitute a common-law marriage, despite the fact that, as mentioned, several were involved in lengthy cohabitating relationships themselves. Moreover, two of such partners testified in complete opposition to one another, with one reporting they were common-law married, and the other stating emphatically they were not. This further persuades us to reject a mechanism which imposes marital bonds upon an ever-growing number of people who do not even understand its triggers.

Our public policy is to promote predictable, just outcomes for all parties involved in these disputes, as well as to emphasize the sanctity of marital union. We can discern no more efficacious way to fulfill these interests than to require those who wish to be married in our State to comply with our statutory requirements. Our quest to see inside the minds of litigants asserting different motivations and levels

> of knowledge at varying times must yield to the most reliable measurement of marital intent: a valid marriage certificate.

Interestingly, the court noted that the South Carolina Legislature had tried eight times since 1998 to eliminate common law marriage. As the court notes, cohabitation is increasingly common. The Uniform Law Commission is drafting an act addressing the Economic Rights of Unmarried Cohabitants.

17. Failure to Discuss Basis Planning. Stevenson v. Stanyer, 2019 WL 2895378 (Wa. Ct. App., Div.3)(unreported).

Income tax basis planning is increasingly a part of estate planning and became the subject of a malpractice claim in Spokane, Washington. Many years ago, Dr. and Mrs. Richard Stevenson transferred a lake house in Idaho into a trust to avoid estate tax on the property. Dr. Stevenson died in 1989 and the trust worked as intended with the property remaining in the trust for Mrs. Stevenson's benefit until her death in 2016. Mrs. Stevenson's children decided to sell the lake house and learned they would owe capital gains taxes whereupon Mrs. Stevenson's son, as executor, sued the lawyer who had updated Mrs. Stevenson's will, power of attorney, and health care directive some six months before she died. The opinion states that the "essence of the complaint" was that the lawyer should have advised Mrs. Stevenson to have entered into an agreement with the trust beneficiaries to dissolve the trust, take the lake house into her personal name, and receive increased basis, none of which would cause any estate tax to be owed because of the increased estate exemption. The damages were $159,000 in capital gains taxes.

The lawyer defended on the grounds that he was not asked to do any tax work on behalf of the beneficiaries. The decedent's son remembered his mother's "clear intention" that her death not result in a taxable event to her estate or her beneficiaries but the court found that there was no evidence such intent was ever expressed to the lawyer. The opinion notes that "[t]here is simply no indication that her desire to avoid tax consequences for the children was ever communicated to Mr. Stanyer. Similarly, the e-mail communications between Stanyer and Stevenson, offered into the record by both parties, do not mention the issue of tax advice." The court concluded that it "is difficult to see how any general duty to provide tax advice for her estate would encompass tax advice for the beneficiaries of the trust she controlled."

Many lawyers make more expansive claims for the sort of advice we are providing to a client, and in many instances actually represent both the parents and children or at least some of the children. Arguably the successful defense made by the lawyer here would be more difficult in such instances.

18. Corporate Stock Gifts Require Stock Certificates. Knop v. Knop, 830 S. E. 2d 723 (Va. 2019).

In 1997, Peter J. Knop owned 72.76% of Ticonderoga Farms which owned 1000 acres in Loudoun County, Virginia and each of his three children owned 9.08%. Mr. Knop then instructed the accountant for the company and the family to reflect annual exclusions to each of the children every year which the accountant did by reflecting the changes in ownership on the Federal and Virginia K-1s filed with each year. This procedure was followed at least through 2004 when each child's interest had risen to 14.687%. The company bylaws required approval of 90% of the owners if real estate were to be sold or given away which became an issue in 2015 when Mr. Knop decided that he wanted to create scenic easement on some of the real estate and the children objected. Virginia law provided that an owner of two-thirds of a company's stock could convert to a different kind of entity which Mr. Knop proposed to do, namely to an LLC which would not have the 90% requirement. The children objected that their father did not own two-thirds of the company but rather they owned 44.061% and he owned 55.939%.

At this point Dad asked a very simple question, at least metaphorically: where are your stock certificates? In fact the children had stock certificates only for the 9.08% they had owned in 1997, not for any of the subsequent gifts. The children made the ingenious argument that delivery of the tax returns was constructive delivery of the stock certificates but the court held that without delivery of the stock certificates there was no relinquishment by Mr. Knop of his interest in the company. The court also rejected an estoppel theory because the children could not show any actual detriment from their increased K-1 percentages, perhaps because the company always distributed enough to pay income taxes.

In Hollinger v. Hollinger, 2020 WL 1313682, ______ So. 3d _____ (Fl. App. 5th Dist. 2020), the parties had not complied with a buy-sell agreement when father conveyed shares. The court concluded that the transfers might or might not be valid depending on the facts, noting that the parties to the lawsuit each agreed they thought the buy-sell was only supposed to apply to transfers outside the family.

All that pesky paperwork churned out by the corporate lawyers really does make a difference. Who knew!

19. Trust Protector As Fiduciary With A Duty To Whom? Ron v. Ron, __________________ (S.D. Tx. 2020), deals with the alleged dissipation of assets in connection with a divorce. Directly pertinent to estate planners is a question addressed by the court regarding a trust protector in a children's trust, the recipient of some of the alleged dissipation. The relevant language of the children's trust was:

> The Trust states: "The purpose of a Trust Protector is to direct my1 Trustee in certain matters concerning the trust, and to assist, if needed, in achieving my objectives as expressed by the other provisions of my estate plan hereunder." Id. at 17. The Trust explicitly empowers the Trust Protector to carry out several duties. Relevant here, the Trust provides:
>
>> The Trust Protector may add as a beneficiary of any trust established hereunder (i) any descendant of my husband's parents; (ii) any spouse or surviving spouse of any such descendant (other than me); and (iii) any charity, subject to any limitations the Trust Protector determine appropriate. The Trust Protector may also remove any beneficiary who was added under this subsection.

The wife was upset because the trust protector added husband as a beneficiary of a trust she had created (to which husband had transferred assets). Wife, Suzanne, claimed the trust protector, Stein, had a fiduciary duty to her. The court held that neither the trust nor Texas law created such a fiduciary relationship:

> In my view, nothing in Section 4.01 of the Trust creates a fiduciary relationship between Stein and Suzanne. If anything, the provision strongly suggests that the fiduciary relationship is between Stein and the Trustee—who Stein is to "direct" and "assist"—or perhaps, between Stein and the Trust—which contains Suzanne's memorialized objectives. *Id*. The mere fact that Section 4.01 references Suzanne's objectives means nothing when the Trust explicitly states that "[a]ll provisions of this agreement are to be construed to accomplish these objectives." *Id*. at 10. Given this reality, literally every provision in the Trust is expressly intended to achieve Suzanne's objectives. Surely, this does not mean that every individual implicated by a given provision has entered a fiduciary relationship with Suzanne.
>
> ***
>
> Though not argued by the parties, I also considered the provision of the Texas Trust Code that mentions trust protectors and their fiduciary duty. Section 114.0031(a)(1) of the Texas Trust Code states: "'Advisor' includes protector." TEX. PROP. CODE § 114.0031(a)(1). Section 114.0031(e) then provides:
>
> If the terms of a trust give a person the authority to direct, consent to, or disapprove a trustee's actual or proposed investment decisions, distribution decisions, or other decisions, the person is an advisor. An advisor is a fiduciary regardless of trust terms to the contrary except that the trust terms may provide that an advisor acts in a nonfiduciary capacity if:
>
> > (1) the advisor's only power is to remove and appoint trustees, advisors, trust committee members, or other protectors; and
> >
> > (2) the advisor does not exercise that power to appoint the advisor's self to a position described by Subdivision.
>
> *See* TEX. PROP. CODE § 114.0031(e). This seems to be the only provision in the Texas Trust Code that discusses the fiduciary duty owed by a trust protector. Notably, the section discusses the trust protector in his role as advisor to the trustee. This suggests that the fiduciary relationship is between Stein (Trust Protector) and Avi (Trustee)— again, or perhaps, between Stein (Trust Protector) and the Trust itself. In other words, Texas law does not create a formal fiduciary relationship between Stein and Suzanne.

20. <u>**Amanuensis Signature Valid in Kansas**</u>. In <u>Matter of Estate of Moore</u>, 310 Kan. 557 (Ks. 2019), the court held that the signature of an amanuensis was valid. The opinion states:

> On April 29, 2004, Roxie executed a durable power of attorney naming Maureen as her attorney-in-fact. At around the same time, Roxie asked Maureen to procure the services of attorney David Andreas to protect the remaining homeplace property from Harvey so that Bart and Ryan could someday take ownership of it. Andreas drafted a transfer-on-death deed assigning the homeplace property to Maureen on Roxie's death.
>
> On May 10, 2004, Stephanie Nulick, a secretary and notary public with Andreas' law office, went to the nursing home where Roxie was living. Roxie was lying in bed. In the presence of Nulick and five other people, Roxie read the transfer-on-death deed; it was also read to her. She checked to make sure that the property description was correct. Ryan asked her if she was sure she wanted to give him

and his brother the property on her death, and she said she was. She said that she was in too much pain to sit up and sign the document, and she asked Maureen to sign for her, saying, “Maureen, I want you to sign it.” Maureen asked if she was certain that she wanted the document signed in that fashion, and Roxie said yes. Maureen then signed Roxie's name, adding a notation that she was signing as a power of attorney.

***

Maureen signed Roxie's name on the transfer-on-death deed and then added: “by Maureen Miles, Power of Atty.” In the district court, as well as in the appellate courts, the respondents did not assert that the power-of-attorney designation validated the deed. Instead, they maintained that Maureen acted purely as an amanuensis, and the power-of-attorney wording was nothing more than surplusage. We therefore will not address whether Maureen could lawfully have signed in her capacity as an attorney-in-fact and will instead consider whether she functioned as an effective amanuensis.

An amanuensis is one who takes dictation or who writes down what another has dictated. See Black's Law Dictionary 99 (11th ed. 2019). “ ‘Where a person's name is signed for him at his direction and in his presence by another, the signature becomes his own, and is sufficient to give the same validity to an instrument as though written by the person himself.’ ” *Gaspard v. Iberia Bank*, 953 So. 2d 997, 999 (La. Ct. App. 2007). This “amanuensis rule” is “so uniformly recognized” that the Nevada Supreme Court, in upholding the validity of a land conveyance executed by an amanuensis, saw no purpose in citing the treatises and “hundreds of cases” supporting its application. *Lukey v. Smith*, 77 Nev. 402, 405-06, 365 P.2d 487 (1961).

***

K.S.A. 59-3501 sets out the procedure for creating and validating a transfer-on-death deed, including a requirement of a signature by the owner of the interest. To be sure, K.S.A. 59-3501(a) does not expressly allow signature by another, but this does not defeat permitting a directed signature by an amanuensis. As Bogert's Trusts and Trustees § 86 (2d. ed. rev. 1984) notes, the one who has the power to make the writing which renders the instrument enforceable will usually sign or subscribe himself,

> “but this is not necessary. He may permit another in his presence to sign ... thus allowing the other to act as an amanuensis, and this will be sufficient. Many statutes also provide for the signing by an agent, and, *even where this is not expressly stipulated, it is doubtless proper* if the agent is in fact authorized to perform this act. ... The signature of the agent alone will satisfy the Statute.” (Emphasis added.)

K.S.A. 59-3501(a) states that a transfer-on-death interest may effectively be created “by recording a deed signed by the record owner of such interest ....” We do not read this statutory language to remove the capacity of a property owner to sign away the interest through an agent or amanuensis. K.S.A. 58-2209 states that “[*a*]*ll deeds* ... shall be subscribed by the party granting the same, *or by the party's lawful agent or attorney* ....” (Emphases added.) The phrase “all deeds” certainly includes transfer-on-death deeds, and we will not give a contradictory construction to the transfer-on-death statute, in light of the extensive and long history of treating a signature by an amanuensis as legally equivalent to a signature by the party directing that the signature be rendered.

> Furthermore, the power-of-attorney statute explicitly permits an agent to designate beneficiaries who will receive property on the principal's death. K.S.A. 2018 Supp. 58-654(f)(6). The Legislature has thus expressed a clear intention that transfer-on-death deeds may be signed by parties who are not the actual property owners. This intention is consistent with the law relating to signatures for other forms of property conveyances. Our understanding of the legislative intention is consistent with the long and widely held law*****432*** of amanuensis: that the party acting as the amanuensis ****564*** signs with the same authority and legal effect as if the signature were physically provided by the principal directing the signature.

The notary acknowledgement stated that the signature was by an attorney-in-fact which was not accurate. That defect did not make the deed ineffective:

> Here, the acknowledgement, although arguably facially valid, was inconsistent with the circumstances under which the deed was signed and notarized. Harvey contends it was improper for the district court to consider parol evidence to show that the notary's acknowledgement certificate contained a judicially correctable error when it referred to Maureen as acting under a power of attorney. We disagree.
>
> A court may properly consider evidence beyond the language of deeds and official signatures in ascertaining whether deeds have been effectively executed and acknowledged. In *Heil v. Redden*, 45 Kan. 562, 565, 26 P. 2 (1891), this court held:
>
> > "[T]he grantee, or any person holding under him, would not be bound by the errors of a register of deeds in transcribing an instrument, and such errors might be explained. Acknowledging officers and registers of deeds are ministerial officers; neither act in a judicial capacity; any and all mistakes made by them may be explained and corrected by proper proof, as readily as mistakes of any other ministerial officers. [Citations omitted.]"
>
> An acknowledgment is not a part of a contract between parties; it "is only *prima facie* evidence of the execution of the deed. If mistakes are made by the officer in taking an acknowledgment they are open to explanation and correction. [Citations omitted.]" *Mathewson, Administrator, v. Richards*, 114 Kan. 500, 503, 220 P. 185 (1923).
>
> The execution of a will may be proved through testimony, and, if it is so proved, it is immaterial whether the deed was acknowledged or not. *Heaton v. Bank*, 59 Kan. 281, 289, 52 P. 876 (1898). The testimony of witnesses to the signing of a deed may render an improperly acknowledged deed valid. *Tawney v. Blankenship*, 150 Kan. 41, 47, 90 P.2d 1111 (1939). Even a completely unacknowledged signed deed conveys the property described as against the grantor and those claiming under the grantor. *Bryant v. Fordyce*, 147 Kan. 586, 589, 78 P.2d 32 (1938); see *In re Adoption of X.J.A.*, 284 Kan. 853, 873, 166 P.3d 396 (2007)(acknowledgment serves as prima facie proof of validity of a transfer of rights but is not essential; other evidence may be introduced to supplement or correct improperly acknowledged instrument).
>
> We therefore conclude that the district court appropriately considered evidence relating to the authority by which Maureen signed the deed, notwithstanding the notary's designation of signature through power of attorney. We further conclude

> that the district court's determination that Maureen signed the deed as an amanuensis was supported by clear and convincing evidence.

The court also rejected claims of undue influence and incapacity.

An interesting dissent objected to dicta in the majority opinion. The dissent believed that an amanuensis could sign a transfer on death deed <u>but not</u> an agent like an attorney-in-fact, because the transfer on death deed act requires the "second owner" to sign.

21. <u>Removal of Corporate Trustee Violated A Material Purpose of Trust</u>. Nebraska has adopted the Uniform Trust Code which allows for the removal of a trustee by the beneficiaries under certain circumstances. Those were at issue in <u>In re Trust Created by Fenske</u>, 930 N.W.2d 43 (Ne. 2019). The court noted the relevant UTC provision:

> Section 30-3862, which became operative in 2005, is identical to § 706 of the Uniform Trust Code. It provides authority for courts to remove trustees under various circumstances. Relevant to this appeal, it provides:
>
>> (a) The settlor, a cotrustee, or a beneficiary may request the court to remove a trustee, or a trustee may be removed by the court on its own initiative.
>>
>> (b) The court may remove a trustee if:
>>
>> ....
>>
>> (4) there has been a substantial change of circumstances or removal is requested by all of the qualified beneficiaries, the court finds that removal of the trustee best serves the interests of all of the beneficiaries and is not inconsistent with a material purpose of the trust, and a suitable cotrustee or successor trustee is available.

So the key question was whether the removal would violate a material purpose of the trust. Nebraska had not addressed that question and the court reviewed the UTC and Restatement commentary:

> Before turning to whether removal of the Bank would be inconsistent with a material purpose of the trust in this case, we pause to consider what that question entails. Crucial to our analysis is, of course, what it means under § 30-3862(b)(4) for a proposed trustee removal to be "inconsistent with a material purpose of the trust." Nebraska's Uniform Trust Code does not define "material purpose." However, the comments to the Uniform Trust Code provide some guidance, and the Legislature directly referred to sections of the code when adopting it, thereby incorporating those comments. See *In re Trust of Shire*, 299 Neb. 25, 907 N.W.2d 263 (2018).
>
> The most guidance regarding the meaning of "material purpose" can be found in the comment to § 411 of the Uniform Trust Code, a provision that makes the material purposes of a trust relevant to whether termination or modification of a trust is permitted. See Neb. Rev. Stat. § 30-3837 (Reissue 2016). We find the comment to § 411 useful, because the comment to § 706 of the Uniform Trust

Code explains that it is "a specific but more limited application of" § 411. Unif. Trust Code § 706, 7D U.L.A. 254 (2018). The comment to § 411 states:

> In order to be material, the purpose ... must be of some significance: "Material purposes are not readily to be inferred. A finding of such a purpose generally requires some showing of a particular concern or objective on the part of the settlor, such as concern with regard to a beneficiary's management skills, judgment, or level of maturity."

Unif. Trust Code § 411, 7D U.L.A. 160 (2018), quoting Restatement (Third) of Trusts § 65, comment *d.* (2003).

The Restatement commentary quoted in the comment on the Uniform Trust Code elaborates further on the meaning of material purpose in this context. It provides:

> Thus, a court may look for some circumstantial or other evidence indicating that the trust arrangement represented to the settlor more than a method of allocating the benefits of property among multiple intended beneficiaries, or a means of offering to the beneficiaries (but not imposing on them) a particular advantage. Sometimes, of course, the very nature or design of a trust suggests its protective nature or some other material purpose.

Restatement, *supra*, § 65, comment *d.* at 477.

> [A] particular change of trustee ... might have the effect of materially undermining the contemplated qualities or independence of trustees. A given change might even have the effect of shifting effective control of the trust in such a way as to be inconsistent with a protective management purpose or other material purpose of the trust. Thus, changes of trustees ... are to be particularly but sympathetically scrutinized for possible conflict with a material trust purpose.

Id., comment *f.* at 481.

Finally, the comment accompanying § 706 states:

> Because of the discretion normally granted to a trustee, the settlor's confidence in the judgment of the particular person whom the settlor selected to act as trustee is entitled to considerable weight. This deference to the settlor's choice can weaken or dissolve if a substantial change in the trustee's circumstances occurs.

Unif. Trust Code, *supra*, § 706, 7D U.L.A. 254.

We understand the commentary set forth above to indicate that the question whether the proposed replacement of a trustee is inconsistent with a material purpose of the trust depends on the significance to the settlor of the initial choice of trustee. For example, there may be cases in which there is no indication that the particular trustee or the qualities that trustee brought to the assignment were an important consideration for the settlor. In those types of cases—where the current trustee is merely an incidental means to accomplish ends—removal would not be inconsistent with a material purpose. Courts from other jurisdictions with the same or similar "no-fault" removal provisions have reached that conclusion. See, e.g., *Matter of Trust of Hildebrandt*, 53 Kan. App. 2d 368, 388 P.3d 918 (2017)

> (where initial trustee was selected by drafting attorney without input from settlor, removal found not to be inconsistent with material purpose); *In re McKinney*, 67 A.3d 824 (Pa. Super. 2013) (where trustee chosen by settlor no longer existed and material purpose could be accomplished by qualified successor trustee, removal found not to be inconsistent with material purpose); *Fleet Bank v. Foote*, No. CV020087512S, 2003 WL 22962488 (Conn. Super. Dec. 2, 2003) (unpublished opinion) (where settlor desired only qualified services and initial trustee no longer existed, removal found not to be inconsistent with material purpose).
>
> On the other hand, however, are cases in which it is important to the settlor that a particular person or entity or a person or entity with particular qualities serve as trustee. The Uniform Trust Code and the Restatement commentary quoted above indicate that in those circumstances, replacement of the selected trustee with another person or entity or a person or entity that lacked the desired qualities would be inconsistent with a material purpose.

The trust beneficiaries were the decedent's great-nieces, Jennifer and Laura. The factual testimony from Laura included the hope that if an individual trustee replaced the corporate trustee the trust might be terminated. The court relied heavily on the testimony of the settlor's attorney:

> Unlike cases in which the settlor's considerations must be deduced from entirely circumstantial evidence, the record in this case contains relatively direct evidence of what Fenske hoped to accomplish through the trust and why he selected the Bank to serve as trustee. As noted above, Fenske's attorney, Stafford, provided testimony regarding his understanding of Fenske's estate planning aims. He testified that Fenske's objective was "to keep [the trust assets] together as long as [they] could possibly be kept together." As for why the Bank was selected as trustee, Stafford noted that Fenske had a history with the Bank and a relationship with its president and that that person was still serving as president of the Bank at the time of trial. Stafford also testified that Fenske wanted a trustee who was "independent." Stafford elaborated on the idea of independence when he was asked if someone other than the Bank could carry out the material purposes of the trust. Stafford responded that "the one thing that I think [Fenske] was really trying to get away from was to have any of his relatives being in charge of his assets."
>
> Based on Stafford's testimony and the terms of the trust, the Bank argues that it would be inconsistent with a material purpose of the trust to replace the Bank with Wilson. The Bank argues that Fenske wanted the trust to be left intact until the deaths of Jennifer and Laura and that it would be inconsistent with his purpose if the Bank was replaced by Wilson as part of an attempt to ultimately terminate the trust. It does appear from both the terms of the trust and Stafford's testimony that it was important to Fenske that the trust assets remain intact until the deaths of Jennifer and Laura. Jennifer and Laura counter, however, that even if the Bank is correct about Fenske's wishes, Wilson could not thwart those wishes as trustee, because he would be bound by the same legal requirements as the Bank and the trust could be terminated only if permitted by the court under a separate motion under § 30-3837.
>
> In the end, we need not resolve whether and to what extent Laura's admission that this motion is part of an attempt to terminate the trust ought to affect the material purpose analysis, because even if it is set to the side, we would find that removal is inconsistent with a material purpose of the trust for another reason. Stafford testified that the Bank was selected because Fenske wanted a trustee that was "independent" and that he did not want a trustee that was a part of his family. This

> testimony suggests that the selection of the Bank as trustee was more than an incidental means to an end, but that independence from his family was, for Fenske, an important quality in a trustee. The Restatement comments we quoted above recognize that a proposed trustee removal and replacement "might have the effect of materially undermining the contemplated qualities or independence of trustees." Restatement (Third) of Trusts § 65, comment *f.* at 481 (2003). In our view, replacing the Bank with Wilson, Laura's husband, would do so here. Because we find that removal of the Bank would be inconsistent with a material purpose of the trust, we conclude that the county court did not err in denying Jennifer and Laura's motion.

Of interest is that the decedent died only in 1998, roughly 20 years before removal was sought. Perhaps a different result would have been reached after more time passed. Also of interest is the size of the trust:

> $52,000 in money market funds, agricultural land assessed at approximately $278,500, and a nearly $ 30,000 debt owed by Jennifer.

The opinion states that over the previous six years the trustee fees exceeded the trust income "slightly".

22. **<u>Decanting Under Wyoming Law</u>**. The Supreme Court of Wyoming agreed that a trustee had "general" decanting authority, but declined to allow a trust court to affirm a <u>particular</u> decanting based on the pleadings in the case alone. It is unclear from the opinion whether the court believed that all decantings would require factual testimony to be sustained, or whether the court believed the parties had simply asked a narrow question about general decanting authority. The opinion states:

> The district court purported to interpret the Trust Agreement, but it did so without considering whether the Trust Agreement was ambiguous or Edward's arguments that the proposed decanting was inconsistent with Bruce's intent, the purpose of the Trust, and the Trust Agreement. In any event, our only point is the district court erred in making factual findings concerning the appropriateness of the proposed decanting because those findings went beyond the discrete legal question both parties agree was before it and those factual issues were disputed and material.

Footnote 16 provides:

> At oral argument, EFM's counsel attempted to wave off the additional factual findings as mere context. But the additional findings went beyond mere background information and certainly could be used to support a future collateral estoppel claim against Edward. *See Eklund v. PRI Envtl., Inc.*, 2001 WY 55, ¶ 15, 25 P.3d 511, 517 (Wyo. 2001) (in general, "[c]ollateral estoppel bars relitigation of previously litigated ***issues*** and involves an analysis of four ... factors: (1) whether the issue decided in the prior adjudication was identical with the issue presented in the present action; (2) whether the prior adjudication resulted in a judgment on the merits; (3) whether the party against whom collateral estoppel is asserted was a party or in privity with a party to the prior adjudication; and (4) whether the party against whom collateral estoppel is asserted had a full and fair opportunity to litigate the issue in the prior proceeding"). EFM's counsel's assurance at oral argument that EFM was not claiming and will not claim the district court's order to have preclusive effect is cold comfort.

The court is careful to note, in Footnote 17, that:

> Nothing in this opinion should be read to preclude Edward from seeking an injunction in the event EFM decides to proceed with the proposed decanting or from seeking relief after the fact. We simply decide this case has ended and a remand is not required. We also emphasize nothing in this opinion should be read as reaching the merits of the parties' arguments concerning the propriety of the proposed decanting.

23. Disinheritance Based On Marriage To Existing Spouse Disallowed Under Virginia Law. Parents do not always approve of a child's choice of spouse. Such was the case in In re Estate of Connolly, 2019 WL 1643856 (Va. Cir. Ct. April 16, 2019) where:

> Mr. Connolly, predeceased by Mrs. Connolly, executed his Last Will and Testament on September 29, 1998 ("the Will"), Mr. Connolly owned and resided in a house located in Alexandria and devised this house to his daughter Susan "for as long as she desires to live there" and further provided:
>
>> Upon [Susan's] death or upon her cessation of living on the premises or any time she chooses to sell the house, the house shall be sold and the net proceeds of such sale shall be divided equally among my surviving children, except that the share which I bequeath to my son, Kevin Brian Connolly, shall not be distributed to him if he is married to the same person he is married to on the date of the execution of this will. Said share shall be divided equally among my surviving children.

The court had no trouble ascertaining the intent of the provision:

> The language of the Will conclusively shows Mr. Connolly's intent for Kevin to divorce Francine. First, Mr. Connolly clearly refers to Francine when he writes: "if [Kevin] is married to the same person he is married to on the date of the execution of this will" because Kevin was married to Francine at the time Mr. Connolly signed the Will and the evidence presented showed that Mr. Connolly was aware of their marriage at this time. Second, "no longer married" clearly expresses his intent for them to divorce. Further, the depositions of Kevin and Father Donahue, the family's priest, show that Mr. Connolly adamantly opposed Kevin's marriage to Francine because he did not attend their wedding and repeatedly expressed his contempt for Francine after they married. Therefore, under the facts of this case, I find that Mr. Connolly, through his Will, explicitly encouraged Kevin to divorce his wife.

Accordingly, the provision was invalid:

> While there is no Virginia common law addressing the validity of will provisions that encourage divorce, there exists strong precedent against wills containing absolute prohibitions of marriage. *See, e.g.*, *Meek v.* Fox, 88 S.E. 161, 163 (Va. 1916) ("It has, by numerous decisions of this court, been held that any contract or provision in general or total restraint of marriage is against the policy of the laws of this state, and this view, it appears, has been uniformly taken wherever the question has arisen."); *Maddox v. Maddox*, 52 Va. (11 Gratt.) 804, 807 (1854) ("[N]ot only should all positive prohibitions of marriage be rendered nugatory, but all unjust and improper restrictions upon it should be removed, and all undue influences in determining the choice of the parties should be carefully suppressed."). Further, Virginia courts have long held that provisions in contracts that encourage divorce are prohibited as against public policy. *See, e.g.*, *Capps v. Capps*, 216 Va. 378 (1975); *Shelton v. Stewart*, 193 Va. 162 (1951). Courts in other states have also deemed that absent a testator's intent to protect the beneficiary, a provision in a will encouraging divorce violates public policy. *See, e.g.*, *Hall v. Eaton*, 259 Ill. App. 3d 319 (4th Dist. 1994). Taking the next logical step, this Court finds that a stipulation in a will that encourages a devisee to divorce his or her spouse, absent an intent to financially protect the devisee, is as loathsome as an absolute prohibition on marriage and therefore violates public policy.

24. <u>**Former Beneficiary Has Standing To Challenge a Revocable Trust Under California Law**</u>. If amendments to a revocable trust made shortly before the settlor dies disinherit a beneficiary, does that individual, as one who is not named in the trust's final iteration, have standing to challenge the validity of the disinheriting amendments in probate court on grounds such as incompetence, undue influence, or fraud? That was the question before the court in <u>Barefoot v. Jennings</u>,456 P.3d 447 (Ca. 2020). The California appellate court had concluded that only a currently named beneficiary could petition a court regarding the existence or "internal affairs" of a trust but the Supreme Court disagreed:

> Our review concerns whether plaintiff has standing to assert the invalidity of the Trust amendments that left her without an interest in her mother's trust estate. In concluding that plaintiff does not have standing to challenge the amendments to the Trust, the Court of Appeal suggested that plaintiff relied exclusively on section 17200, subdivision (a), which provides: "Except as provided in Section 15800, a trustee or beneficiary of a trust may petition the court under this chapter concerning the internal affairs of the trust or to determine the existence of the trust." Section 15800 generally provides that so long as the trust remains revocable (that is, as long as the settlor is alive) and the settlor is competent, the settlor, "and not the beneficiary, has the rights afforded beneficiaries under this division." (*Id*., subd. (a); see *Estate of Giraldin*, *supra*, 55 Cal.4th at p. 1066, 150 Cal.Rptr.3d 205, 290 P.3d 199.) Here, the settlor (Maynord) has died, so section 15800 is no longer relevant.
>
> ***
>
> The applicable Probate Code provisions support plaintiff's standing to challenge the merits of the Trust amendments on the grounds of incompetence, undue influence, or fraud. Section 17200, subdivision (a), authorizes a beneficiary to petition the court concerning the trust's affairs "or to determine [its] existence." Section 17200, subdivision (b)(3) contemplates the court's determination of "the

> validity of a trust provision." Plainly, the term "trust provision" incorporates any amendments to a trust. Section 24, subdivision (c) defines a "beneficiary" for trust purposes, as "a person who has any present or future interest, vested or contingent." Assuming plaintiff's allegations are true, she has a present or future interest, making her a beneficiary permitted to petition the probate court under section 17200.
>
> ***
>
> Reading the Probate Code section consistent with the statutory scheme as a whole, and examining the statutory language to give it commonsense meaning, we conclude that claims that trust provisions or amendments are the product of incompetence, undue influence, or fraud, as is alleged here, should be decided by the probate court, if the invalidity of those provisions or amendments would render the challenger a beneficiary of the trust. (See *Coalition of Concerned Communities, Inc. v. City of Los Angeles* (2004) 34 Cal.4th 733, 737, 21 Cal.Rptr.3d 676, 101 P.3d 563 [courts should not examine statutory language in isolation].) So when a plaintiff claims to be a rightful beneficiary of a trust if challenged amendments are deemed invalid, she has standing to petition the probate court under section 17200.
>
> Defendants argue that interpreting section 17200 to permit purported beneficiaries to challenge a trust or its amendments would "invite chaos" because it would permit individuals with no present interest in the trust to "meddle" with its administration. We think defendants overstate the matter. Our holding does not allow individuals with no interest in a trust to bring a claim against the trust. Instead, we permit those whose well-pleaded allegations show that they have an interest in a trust — because the amendments purporting to disinherit them are invalid — to petition the probate court.

25. **<u>Charitable Trust Beneficiary Standing</u>**. The Maine version of the Uniform Trust Code grants standing to a charitable beneficiary that is a "qualified beneficiary." A charity is a designated beneficiary if it is "expressly designated to receive distributions" under the trust and, on the relevant date is a distributee or permissible distributee of income or principal. At issue in <u>Attorney General v. Sanford</u>, 225 A.3d 1026 (Me. 2020), was whether this permissive language made the charity expressly designated:

> All or any part of the net income and principal may be paid for the charitable purposes of 1) providing educational and scientific study of ant[iq]ue automobiles, whether owned by the trust or any other charitable organization, and other methods of transportation, 2) providing for the display to the public of antique automobiles, whether owned by the trust or any other charitable organization, and 3) maintaining in suitable condition for public display and study any antique automobiles owned by the trust or any other charitable organization.
>
> In furtherance of the foregoing purposes the Trustee may, without limitation, sell such automobiles as he from time to time deems necessary or advisable, whether to provide a suitable endowment to maintain the Collection or to permit the continued display of antique automobiles by Seal Cove Auto Museum or by any other museum[;] ... loan all or any part of the Collection to museums, including without limitation Seal Cove Auto Museum, or other charitable organizations ... for public display or study; permit access to the Collection for

> educational purposes by scholars or students; and generally do all such acts as may be necessary or appropriate to educate the public with respect to antique automobiles and to make the Collection available for public viewing.

The opinion states:

> We now consider whether Seal Cove is "expressly designated to receive distributions under the terms of" the Trust. *Id.* § 110(1). In particular, we must determine whether a charitable organization satisfies this requirement by showing that it is expressly *permitted* to receive distributions from the trust or whether a charitable organization must show that it is expressly *mandated* to receive distributions from the trust. Because the Declaration of Trust expressly authorizes the Trustees to make distributions to Seal Cove, but does not require them to do so, the resolution of this appeal turns on the meaning of the word "designated."
>
> In statutory interpretation, we first examine "the plain meaning of the statutory language in the context of the whole statutory scheme." *Sunshine v. Brett*, 2014 ME 146, ¶ 13, 106 A.3d 1123. "Only if the statutory language is ambiguous—that is, reasonably susceptible to more than one interpretation—will we consider other indicia of legislative intent." *Id.*
>
> The meaning of 18-B M.R.S. § 110(1) is established when it is compared to section 103(12), which articulates the definition of a qualified beneficiary of a private trust. Title 18-B M.R.S. § 103(12) states:
>
>> "Qualified beneficiary" means a living beneficiary who on the date the beneficiary's qualification is being determined:
>>
>> **A.** Is a distributee or permissible distributee of trust income or principal;
>>
>> **B.** Would be a distributee or permissible distributee of trust income or principal if the interests of the distributees described in paragraph A terminated on that date, but the termination of those interests would not cause the trust to terminate; or
>>
>> **C.** Would be a distributee or permissible distributee of trust income or principal if the trust terminated on that date.
>
> Title 18-B M.R.S. § 110(1) similarly provides:
>
> A charitable organization expressly designated to receive distributions under the terms of a charitable trust has the rights of a qualified beneficiary under this Code if the charitable organization, on the date the charitable organization's qualification is being determined:
>
>> **A.** Is a distributee or permissible distributee of trust income or principal;
>>
>> **B.** Would be a distributee or a permissible distributee of trust income or principal upon the termination of the interests of other distributees or permissible distributees then receiving or eligible to receive distributions; or
>>
>> **C.** Would be a distributee or permissible distributee of trust income or principal if the trust terminated on that date.

> The Legislature's use of nearly identical language in sections 103(12)(A)-(C) and 110(1)(A)-(C) demonstrates its intent that a charitable organization may assert the rights of a qualified beneficiary only if it has a beneficial interest in a charitable trust *equal* to that of a qualified beneficiary of a private trust. *Cf. Great N. Nekoosa Corp. v. State Tax Assessor*, 675 A.2d 963, 967-68 (Me. 1996)(Clifford, J., dissenting) (citing *Sullivan v. Stroop*, 496 U.S. 478, 484, 110 S.Ct. 2499, 110 L.Ed.2d 438 (1990)) ("Identical words in different parts of the same statute are presumed to have the same meaning." (emphasis omitted)). Thus, a charitable organization does not need to show that the terms of the trust make it a mandatory distributee in order to satisfy the "expressly designated" requirement.
>
> Our reading of section 110(1) comports with the canon of statutory interpretation that "[w]ords in a statute ... be given meaning and not treated as meaningless and superfluous." *Wong v. Hawk*, 2012 ME 125, ¶ 8, 55 A.3d 425. Reading the word "designated" as "mandated" would eviscerate the phrase "or permissible distributee" as it is used in section 110(1)(A) because a charitable organization that is expressly mandated to receive distributions under the terms of the trust would not be a "permissible distributee," but simply a "distributee." We will not interpret a statute in such a way as to render some words meaningless. *See id.*

The Commentary to the UTC suggests the opposite result but the court expressly ignored it:

> The Trustees argue that Uniform Trust Code commentary to section 110 supports their interpretation of the word "designated." That commentary states that to have the rights of a qualified beneficiary, a charitable organization "must be named in the terms of the trust and must be designated to receive distributions," and therefore "excluded are organizations who may receive distributions only in the trustee's discretion ...." 18-B M.R.S.A. § 110 Unif. Trust Code cmt. (2012). The Trustees argue that this shows that the word "designated" must be read to mean "mandated."
>
> This argument fails because the plain language of section 110(1), as adopted by the Legislature, unambiguously provides a different directive. The language used by the Legislature gives Seal Cove the rights of a qualified beneficiary. The commentary to the UTC is not part of the statute and cannot create an ambiguity where none exists. *See* Sunshine, 2014 ME 146, ¶ 13, 106 A.3d 1123.

In Hadassah v. Melcer, 268 So.3d 759 (Fl. App. 2019), the court found that Hadassah was a qualified beneficiary where the trust provided:

> The trust was created in 1989 by Sylvia Gelt. The trust instrument provided that upon her death, a portion of the trust fund was to be placed in a Credit Shelter Trust for her husband, Samuel. Upon his death, the balance of the Credit Shelter Trust was to be divided into three separate trusts for the benefit of their daughters.
>
> During their lifetimes, the daughters have the right to receive income and principal distributions from their respective trusts. They do not have general or testamentary powers of appointment over any portion of the principal or undistributed income of their respective trusts.
>
> The trust instrument provides that upon the death of each daughter, her trust terminates and the balance of the principal and any undistributed income is redistributed to the trust(s) of the remaining living daughter(s). When the last

daughter dies, the trust terminates and the trustee is instructed to distribute the remaining principal and undistributed income to three named charities.

26. **Trustee Liable For Delay In Distributing Trust Proceeds Under South Carolina Law**. In Deborah Dereede Living Trust dated December 18, 2013 v. Karp, 831 S.E.2d 435 (SC. App. 2019), the court held "as soon as practicable" meant just that. The clause in question provided:

> As soon as practicable following my death, my Trustee shall sell the house and lot located at 131 WHISPERING PINES DR., LAKE WYLIE, SC 29710. The sales proceeds shall be used first to pay off any mortgage against the property, and second to pay off that certain promissory note given by me to TYRE DEALER NETWORK CONSULTANTS, INC. Said promissory note, at the time of the execution of my Trust, is in the amount of $250,000.00, but in no event shall the amount due exceed one-half of the sales price of the property. After payoff of said mortgage and said note, my Trustee shall then distribute one-half of the remaining net sales proceeds to HUGH DEREEDE, outright and free of trust. The other one-half of the remaining net sales proceeds shall be distributed in accordance with the Articles that follow.

So the house sold but the executor and trustee wanted to wait until the creditor's claims period expired because under South Carolina assets in a revocable trust could be reached by probate creditors. The court held no:

> We agree with the trial court that the trust's directive that Karp sell the house "as soon as practicable" and distribute the proceeds to Tyre and Hugh did not permit Karp to wait until she could ascertain the liquidity of the estate and the extent of any creditors' claims. Such a delay is common and often required in the probate of a person's estate, but as Medlin [beneficiary's expert] testified, the unique trust provision here required expedited distribution to Tyre and Hugh. Medlin acknowledged Karp's position was understandable and not one of bad faith, for § 62-3-505(a)(3) makes revocable trust assets subject to probate claims if the probate estate is insufficient to pay its creditors. But, as Medlin emphasized, Karp risked no personal liability by following Deborah's intent to expedite distribution***343** of the house sale proceeds, as the Trust Code insulated her and allowed creditors to follow the money and recover against the distributee. *See* S.C. Code Ann. § 62-7-604(b) (Supp. 2018). Medlin also noted in his affidavit that a personal representative or trustee is only liable to non-beneficiaries if they are personally at fault. *See* S.C. Code Ann. § 62-3-808 (Supp. 2018); S.C. Code Ann. § 62-7-1010(b) (Supp. 2018); *see also* S.C. Code Ann. § 62-7-1002 (Supp. 2018) (stating trustee only liable to beneficiaries for breach of fiduciary duty). He also testified the trust provision at issue was an expression of Deborah's intent that the distributions to Tyre and Hugh be given priority and expedited.

27. **Living Trust As Guarantor**. In JPMorgan Chase Bank, N.A., v. Larry J. Winget, Larry J. Winget Living Trust, ____________________ (6th Cir. 2019), the court held that where a living trust guaranteed a debt the lender could collect against the trust property. The settlor argued that because the trust was revocable the obligation was really his, and, on the facts, his liability was capped (and he had paid). The court rejected that position in this oft-litigated matter (the court noted six appeals it had decided in the case):

> Trusts usually honor their obligations from the property they hold. That saves everyone (courts included) a lot of time and expense. But if they don't, their

> creditors aren't just out of luck. That wouldn't make much sense. Instead, the creditors can sue to recover from the trust property—just like with any other contract. There's ample authority for this point. *See, e.g.*, Mich. Comp. Laws § 700.7910(3); *Bankers' Tr. Co. of Muskegon v. Forsyth*, 254 N.W. 190, 192 (Mich. 1934); *Bogert's Trusts and Trustees* § 715, at 303–05 (3d ed. 2009); 4 *Scott and Ascher on Trusts* §§ 26.2, 26.5.4, at 1875–78, 1905–06 (5th ed. 2007); 12 *Williston on Contracts* § 35:81, at 777 (4th ed. 2012); Restatement (Third) of Trusts § 105 (2012). So although the terminology may seem complicated, the takeaway is quite simple: a party who has a contract with a trust can recover from the property held by the trust.
>
> That quick review tells us all we need to decide this case. Under both Michigan law and the trust agreement, Winget had the power to enter into contracts on behalf of the Trust. *See* Mich. Comp. Laws § 700.7817. Winget did so with Chase. And now the bank wants to collect on that agreement. The district court correctly held that it could do so from the trust property.
>
> Perhaps understandably (given the stakes of the case), Winget resists this straightforward conclusion. The short of his argument is that *he* "owns" the trust property because he can revoke the Trust at any time. *See generally* Restatement (Third) of Trusts § 74 (2007). Thus, he says, Chase can't take the property to satisfy *the Trust's* obligation. The short of our answer is that it doesn't matter who "owns" the trust property (at least as trust law uses that term). After all, trusts usually don't "own" property. *See, e.g., Wellpoint, Inc. v. Comm'r*, 599 F.3d 641, 648 (7th Cir. 2010); Restatement (Third) of Trusts § 2 cmt. d (2003). So if ownership mattered, creditors of a trust—revocable or not—could almost never recover from the trust property. And that would surely surprise the many authorities who have written to the contrary. *See, e.g., Bankers' Tr. Co.*, 254 N.W. at 192–93; *Talmer W. Bank v. Stewart*, Nos. 316678 & 317420, 2014 WL 7003885 (Mich. Ct. App. Dec. 11, 2014) (per curiam).

In passing the court refers to another interesting issue – what if the settlor had revoked the trust. The opinion states:

> To be sure, this does not resolve whether Winget could revoke the Trust and simply remove all the trust property. Winget tried to do exactly that back in 2014 but later reversed course. In related proceedings, the district court held that this revocation was a fraudulent conveyance under Michigan law. *See* Mich. Comp. Laws § 566.35. But if Winget "owns" the trust property, that may affect whether the district court was correct. At oral argument, we asked the parties whether we should address this issue in the current appeal. But they did not pursue that suggestion. Our decision therefore does not address the fraudulent conveyance issue.

28. **<u>Language Regarding Company Stock Precatory</u>**. A handwritten codicil was at issue in <u>Matter of Harold Ankrum Trust Administration</u>, 449 P.3d 822 (Mt. 2019). The facts were simple:

> Harold and Della were married and had three children together: Stewart Ankrum, Linda Hertoghe, and Daniel Ankrum. Harold passed away November 21, 1993. Della passed away September 19, 2016. Before Harold's death, Harold and Della executed identical wills, providing that the assets of the first spouse to die would go into a trust for the benefit of the surviving spouse during his or her lifetime with the assets distributed equally between their three children upon the death of the surviving spouse. Because Della survived Harold, his assets were distributed

> into the Trust upon his death. The net income of the Trust was payable to Della during her lifetime and upon her death "[a]ll remaining trust property shall be distributed in separate, equal share to [his] children." Harold's Will appoints Linda's husband, Calvin Hertoghe, as trustee. Under the terms of Della's Will because she survived Harold, Della "devise[d] the remainder of [her] estate in separate, equal shares to [her] children." Della's Will appoints Calvin as the personal representative of the Estate.
>
> ***
>
> After Della's death, Calvin found a handwritten codicil to Della's Will in a cupboard in her home. The codicil was dated March 9, 2016. Titled "addition to my will," it devised $4,000 to each of her five great-grandchildren. In a separate paragraph, below her signature she further hand wrote
>
> > Also Stewart Ankrum—son
> >
> > If at all possible should get control of Ankrum Trucking.
> >
> > Have full ownership.
>
> The parties do not dispute the validity of the codicil and the devise of money to each great-grandchild. If Stewart received all of the shares of Ankrum Trucking from the Estate, he would own about forty percent of the company. With one-third of the shares from the Trust, he would own over fifty percent of the company.

The court held the codicil was precatory:

> Unlike the Will itself, the contested language of the codicil lacks direct terms of bequest. Della's Will states: "If my husband fails to survive me, I devise the remainder of my estate in separate, equal shares to my children." In contrast, the codicil contains qualifying language: "If at all possible" Stewart "should get control of Ankrum Trucking." This qualifying language is precatory, expressing a desire rather than a command. The codicil language does not "provide[ ] a clear directive." *In re Charles M. Bair Family Tr.*, ¶ 36. Further, Della's codicil concludes that Stewart should "[h]ave full ownership." But given the division of the company stock between the Estate, the Trust, and the three children, it is impossible for Stewart to get full ownership of Ankrum Trucking with a bequest of the stock in Della's estate alone. For Stewart to have "full ownership" would require transfers from Linda and Daniel. The District Court correctly interpreted the language of the codicil as precatory, expressing a desire or a wish, rather than a specific devise of the Ankrum Trucking shares to Stewart.
>
> Evidence Della wished Ankrum Trucking to continue operating, and Stewart was the only child willing to do so, did not overcome the intent expressed in the words of her Will that Della intended to treat her children equally and evidence she had carefully treated each child equally during her life. Based on the words Della used and in consideration of the document as a whole and the surrounding circumstances, the District Court correctly interpreted Della's codicil as lacking in testamentary intent to specifically devise her shares of Ankrum Trucking to Stewart.

29. **<u>Attorney-In-Fact's Power To Make Gifts Under Virginia Law</u>**. Virginia has adopted the Uniform Power of Attorney Act which in <u>Davis v. Davis</u>, 835 S.E.2d 888 (Va. 2019), the court described as allowing the attorney-in-fact to make gifts "*only if* the power of attorney *expressly grants* the agent the authority and exercise of the authority is not otherwise prohibited or limited by another statute, agreement, or instrument to which the authority or property is subject." Code § 64.2-1622(A)(2) (emphases added).

The attorney-in-fact argued that in the power to sell and convey, the "convey" language included to give. The court held no:

> In the present case, the Family and the Estate point to Agnes' authority to "sell and convey" Dickey's property, stated in the power of attorney document, as an express grant of authority for Agnes to make gifts on Dickey's behalf. In other words, the Family and the Estate claim that by authorizing Agnes to "sell and convey" Dickey's personal and real property, the power of attorney expressly authorized Agnes to, in her discretion, gift any such property.
>
> To "sell" means to "transfer (property) by sale." Black's Law Dictionary 1634 (11th ed. 2019). To "convey" is to "transfer or deliver (something, as a right of property) to another, esp. by deed or other writing." Black's Law Dictionary 421 (11th ed. 2019). There is little Virginia case law interpreting the phrase "sell and convey."
>
> In *Pratt v. Taliaferro*, 30 Va. (3 Leigh) 419, 421 (1832), we examined a will that devised land to the executors of the will "that they may sell and convey" the land and "that the produce of the sale be equally divided between her daughter and grand daughter." (Emphasis omitted.) We concluded that this language "impress[ed] upon it *the character of money*." *Id.* at 421–22 (emphasis added). *Pratt* therefore suggests that the phrase "sell and convey" contemplates transfers for adequate consideration.
>
> Similarly, in *Whitford v. Gaskill*, 345 N.C. 475, 480 S.E.2d 690, 691 (1997), the Supreme Court of North Carolina noted that a
>
>> power of attorney authorizing an agent *to sell and convey property*, even though it authorizes him to sell for such price and on such terms as to him shall seem proper, *implies a sale for the benefit of the principal, and does not authorize the agent to make a gift of the property*, or to convey or transfer it without a present consideration inuring to the principal.
>
> (Emphases added) (citation and internal quotation marks omitted). It held, however, that a provision giving an attorney-in-fact "the power to transfer [ ] real estate" included the power to gift such real estate. *Id.* at 692 (internal quotation marks omitted).
>
> ***
>
> Here, Dickey's power of attorney authorized Agnes to "sell and convey any and all personal property and all real property [Dickey] may own and execute and deliver an instrument for the same." The phrase "sell and convey" is a legal doublet that reflects the typical process for real estate transactions: a contract of sale, and the closing and passing of title by deed. Because we construe powers of attorney strictly and Code § 64.2-1622(A)(2) requires a power to be "expressly granted," "sell and convey" should be construed narrowly. Strictly construed and employing its obvious meaning, "sell and convey" does not include the authority to make gifts or transfers for inadequate consideration. Like in *Pratt* and *Whitford*,

> the phrase contemplates that a transfer must be for adequate consideration, and thus it does not expressly authorize the gifts of Dickey's property granted by Agnes.
>
> Although "convey," standing alone, includes the ability to make gifts, Agnes only has the authority to "sell *and* convey" Dickey's property. The Family and the Estate read the term "convey" in isolation, arguing that Agnes had the authority to convey Dickey's property without selling it. The Family and the Estate therefore construe the "and" as an "or" to mean that Agnes' execution of one term ("convey") does not require execution of the other ("sell"). Such a construction alters the obvious meaning of "and," extending Dickey's power of attorney document "beyond the terms in which it is expressed" and violating the strict construction required for powers of attorney. *See Jones*, 274 Va. at 137, 645 S.E.2d 312.

Virginia might have allowed the gifts if they had been consistent with prior gifting but the court determined they were not.

30. **<u>Sometimes It Depends On What The Meaning Of "Lives In" Is</u>**. In <u>DeMott v. DeMott</u>, 836 S.E.2d 612 (Ga. App. 2019), the court confronted the following grant:

>> It is my desire that my spouse, Cynthia Slocumb DeMott, shall have the right to *live* [in] our home, subject to any indebtedness secured thereby, for as long as she so desires provided that she *resides* in the home as her primary residence for at least nine months out of the year and so long as she remains unmarried. At my spouse[']s death, remarriage or at such time as she fails to *live* in our home as her primary residence for at least nine months out of the year, all interest in my home shall pass to Gin Creek, LLC.

In 2016, apparently Cynthia only "resided" in the house for 60 days. A lawsuit ensued wherein Cynthia argued the language meant "intends to reside" and Douglass (member of the LLC remainder beneficiary) argued that the clause means "physically" reside in, but both agreed the language was unambiguous. The opinion states:

> Turning to the pertinent terms of the will, we are unpersuaded by the parties' stipulation below that the will is unambiguous. The will provides that Cynthia has a life estate in the McNeal House "for as long as she so desires" and that the life estate is conditioned upon, among other things, "that she reside[ ] in the home as her primary residence for at least nine months out of the year." In support of her interpretation, Cynthia relies on the legal definition of "resides" and points to evidence that she held out the McNeal House as her legal residence, including receiving her mail and bills there and listing the house as her primary residence on her tax returns. We find that the first sentence of Item II (a) might reasonably be interpreted to support Cynthia's assertion that no physical presence in the McNeal House is required so long as she intends to use the house as her primary residence.
>
> In contrast, Douglas points us to the sentence immediately following:
>
>> At my spouse[']s death, remarriage or at such time as she fails to *live in our home* as her primary residence for at least nine months out of the

> year, all interest in my home shall pass to Gin Creek, LLC. (Emphasis supplied.)

> The phrase "live in our home" is not a legal term and in connection with a house, the verb "to live" commonly means "to occupy a house: DWELL, RESIDE." Webster's New Third International Dictionary 1323 (1966). Douglas also asserts that the following subparagraph further indicates Richard's intention that Cynthia physically live or "remain" in the home:
>
> > All my household furniture and furnishings, books, pictures, objects of art, I give and bequeath to Gin Creek, LLC; but it is my desire, though no[t] a directive, that as long as my wife *remains in the house*, as stated in section (a) above, that these items remain in the house for her use. (Emphasis supplied.)
>
> When considered together, these provisions could also reasonably be interpreted to support Douglas' assertion that his brother only intended for Cynthia to retain the life estate so long as she actually occupies or lives in the home "for at least nine months out of the year." See *Anderson v. Anderson*, 299 Ga. 756, 759 (2), 791 S.E.2d 40 (2016) (although one sentence, considered alone, appeared sufficient to convey a fee simple interest, the sentence immediately following conveyed a clear intent to grant only a life estate).
>
> Because the will uses the alternative and seemingly interchangeable words "live," "reside," and "remain" to describe the conditions of Cynthia's life estate, and these words are capable of multiple, reasonable interpretations, parol evidence is therefore necessary to resolve this ambiguity and ascertain Richard's intent in devising the life estate. See OCGA § 53-4-56 ("In construing a will, the court may hear parol evidence of the circumstances surrounding the testator at the time of execution to explain all ambiguities, whether latent or patent."); *Legare v. Legare*, 268 Ga. 474, 476, 490 S.E.2d 369 (1997); *Bd. of Regents v. Bates*, 262 Ga. 307, 310 (1), 418 S.E.2d 8 (1992). Accordingly, we reverse and remand this case for further proceedings consistent with this opinion. See *Scheridan v. Scheridan*, 132 Ga. App. 210, 211 (2), (3), 207 S.E.2d 691 (1974). In so holding, we do not reach the issue of whether Cynthia has in fact satisfied any of the conditions of the life estate.

A concurrence would have held that Cynthia could use the residence until she established another primary residence:

> Under the operative language of subparagraph II (a), Cynthia DeMott forfeits her life estate if she "fails to live in [the former marital] home as her primary residence for at least nine months out of the year." That language, particularly when read as in the context of the will as a whole, and in light of "the law ... [dis]favor[ing] conditions remediable by forfeiture," *Kale v. Wilson*, 284 Ga. 536, 537, 668 S.E.2d 729 (2008), establishes unambiguously a precondition to forfeiture: another residence. Cynthia DeMott cannot be said to have "fail[ed] to live in [the former marital] home as her primary residence" unless and until she establishes another "primary residence."
>
> ***
>
> So from a reading of the will as a whole, the objectives that emerge are the continued orderly operation of the testator's businesses and the orderly transfer of his assets to his descendants. The testator sought to avoid litigation. And he sought

> to discourage Cynthia DeMott from taking against the will by asserting her statutory right to a year's support.
>
> Construing the forfeiture provision at issue to be triggered only if and when Cynthia DeMott establishes another primary residence subserves those objectives. As the majority explains, the former marital residence is a part of Gin Creek Plantation. Gin Creek, LLC, rents out other houses located there. So if Cynthia DeMott were to use it as rental property or simply abandon it, she would interfere with Gin Creek's operations and so subvert those objectives. She would not subvert those objectives by traveling for work, pleasure, or the discharge of family obligations — such as the obligations to her seriously ill mother that have required her to be away from the marital residence for significant periods of time. Nor would her purchase of a vacation home subvert them — unless the vacation home became her primary residence, and she abandoned the former marital residence.

31. **Declaratory Judgment Action Does Not Trigger No Contest Clause**. At issue in Hunter v. Hunter, 838 S.E.2d 721 (Va. 2020), was whether Chip, a beneficiary of a trust known as Theresa's Trust, triggered a no contest clause by filing an action questioning the inform and report provisions of the trust. Eleanor, the trustee, argued yes. The complaint that Chip filed had two counts the court described as follows:

> Chip filed this declaratory judgment action, seeking a favorable interpretation of the trust that would require Eleanor to provide Chip with information and documents related to the trust. Aware of the no-contest provision in the Theresa Trust, Chip divided his declaratory judgment complaint into two carefully worded counts. Count II acknowledged the ultimate goal of the litigation by asserting that Chip sought the "determination of the rights of Chip and Eleanor" under the terms of the Theresa Trust to require the trustee to inform and report under Code § 64.2-775, other various provisions of the Virginia Uniform Trust Code, or stand-alone principles of common law and equity jurisprudence. The rationale behind Count II, as Chip explained to the circuit court in a subsequent brief, was that he interpreted the language of the inform-and-report waiver provision to only apply to the duty to inform and report under former Code § 55-548.13 and to have no effect on what he interpreted as freestanding inform-and-report duties arising under other sources of law. *See* R. at 177-85. Based upon prior communications with Eleanor's counsel, Chip understood Eleanor's position to be that the waiver provision relieved her of any and all inform-and-report duties.
>
> The complaint expressly sought to create a firewall protecting Count I from any uninvited, premature consideration of Count II. Prior to the complaint's allusion to the competing interpretations of the inform-and-report waiver provision, Count I requested that the circuit court "initially determine" whether determining Chip's and Eleanor's rights and duties under the trust "would constitute a 'contest' " under the no-contest provision, thereby triggering the forfeiture of Chip's beneficial interest in the trust. J.A. at 3. Count I stated that the court should consider the request in Count II "if, and only if," the court interpreted the no-contest provision to be inapplicable. *Id.* Relying on our decision in *Virginia Foundation of Independent Colleges v. Goodrich*, 246 Va. 435, 436 S.E.2d 418 (1993), the complaint insisted that it sought "no further relief than that which has been held by the Virginia Supreme Court ... to permit a beneficiary to file a declaratory judgment action seeking an interpretation ... without such conduct being held to fall within the scope of a no contest clause and/or actuating a no contest clause." J.A. at 3. In Count I, Chip contended that he "merely [sought] an interpretation of the language of the Trusts with respect to the rights and duties of

> Chip and Eleanor," and thus, Count II did not trigger the application of the no-contest clause. *Id.* at 11.

The no contest clause and the reasoning of the lower court, the opinion summarized this way:

> The circuit court held that Count II of the complaint had triggered the no-contest provision and, on this basis, ordered the forfeiture of Chip's interest in the Theresa Trust. Even if it were true that Count II had violated the no-contest provision, the court erred by disregarding the if-and-only-if proviso of Count I and ordering a forfeiture based upon Count II. Instead, in such a scenario, the circuit court should have entered judgment on Count I in Eleanor's favor and dismissed Count II as moot.
>
> That said, we do not accept the first premise of the circuit court's reasoning that Count II violated the no-contest provision. Whether such a violation has occurred "depends upon the wording of the 'no contest' provision and the facts and circumstances of each particular case." *Womble*, 198 Va. at 529, 95 S.E.2d 213; *see also Goodrich*, 246 Va. at 439, 436 S.E.2d 418. In the first paragraph of the self-styled "IN TERROREM PROVISION" of the trust, Theresa provided background context explaining her intent:
>
>> I have from time to time made gifts and provided financial support to each of my children and to my grandchild as I wished, and as my husband and I determined to be necessary to their circumstances. Except as otherwise expressly set forth in this document, the share for any beneficiary hereunder shall not be affected by any gifts or loans to any beneficiary hereunder.
>
> J.A. at 254. The next paragraph of the no-contest provision begins: "I desire that my children and grandchild not expend resources *disputing loans, gifts or bequests that I have made*." *Id.* (emphasis added). Theresa then sought to enforce that desire by declaring:
>
>> Therefore, if any beneficiary under this Trust Agreement takes any one or more actions described in this paragraph, then the interest of such beneficiary under this Trust Agreement shall be revoked, and such beneficiary shall be deemed to have predeceased me without surviving descendants for all purposes under this Trust Agreement, effective as of the date such action is taken.
>
> *Id.* One of the "actions" triggering the forfeiture was "[c]ontest[ing] any provision of this Trust Agreement." *Id.*
>
> The no-contest provision provided a specific definition for a prohibited "contest" of the trust: "For purposes of this Article, a person shall be deemed to contest an instrument or action, if he or she takes any action seeking to invalidate, nullify, set aside, render unenforceable, or otherwise avoid the effect of such instrument, action or transaction." *Id.* at 255. A caveat, however, followed this definition:
>
>> The preceding paragraph shall take effect regardless of whether such contest is made in good faith or is ultimately successful, provided, however that a petition made in good faith and not objected to by my Trustee hereunder, seeking an interpretation of this or any other instrument, shall not be considered a contest of such instrument.

> *Id.*
>
> Focusing on the sentence defining "contest," Chip asserts that Count II never sought to "invalidate, nullify, set aside, render unenforceable, or otherwise avoid" any provision of the Theresa Trust. *Id.* Nor did he violate his mother's "desire" that no beneficiary should "expend resources disputing loans, gifts or bequests" that she had previously made. *Id.* at 254. Instead, when properly construed, Count II merely sought an interpretation of the trustee's inform-and-report duties under other sources of law that would be wholly unaffected by the waiver provision. The circuit court disagreed with Chip and ordered the forfeiture of his interest in the trust. We believe the court erred in doing so.

Eleanor, the trustee, argued that the no contest cause was triggered because she did not agree to the petition. The court flatly rejected that argument stating:

> Eleanor acknowledges this general rule but argues that the no-contest provision in the Theresa Trust required forfeiture even if Chip sought only a judicial interpretation of its provisions. Skipping over the sentence defining "contest," Eleanor lays emphasis on the proviso that follows. That proviso, broken out below for clarity, purports to recognize an exception to the no-contest provision:
>
> - *provided*, however that a petition
>   - made in *good faith* and
>   - *not objected to by my Trustee* hereunder,
>   - seeking an *interpretation* of this or any other instrument,
> - shall not be considered a contest of such instrument.
>
> *See* J.A. at 255 (emphases added). Eleanor argues that this proviso extends the no-contest provision to a beneficiary's good faith petition for a judicial interpretation of the trust if she, as trustee, objects to the request. To her, the meaning of the provision is quite clear: A request for a judicial interpretation of the trust constitutes a contest triggering forfeiture so long as she says so. We have several concerns about this argument.
>
> To begin, we have never addressed (much less approved) a no-contest provision seeking to seal the courthouse doors to a litigant seeking an interpretation (rather than an invalidation) of a trust or will provision. Several courts have criticized such an effort as an impermissible overreach inconsistent with the traditional boundaries of no-contest provisions. Leading commentators have taken a similar view.[11] We need not resolve that question in this case, however, because the proviso Eleanor relies upon merely implies, but does not expressly state, that her mother intended to include a request for judicial interpretation within the definition of a contest, thus warranting a forfeiture. In this area of legal draftsmanship, mere implications will not suffice.
>
> As we noted earlier, forfeiture provisions are "strictly construed," *Rafalko*, 290 Va. at 395, 777 S.E.2d 870, because "equity abhors forfeitures," *Jones*, 101 U.S. at 628, and because "provisions that require forfeiture are not favored in the law and will not be enforced except according to their clear terms," *Rafalko*, 290 Va. at 402, 777 S.E.2d 870. To be effective, the provision must "precisely express"

> an intent to cause a forfeiture. *Keener*, 278 Va. at 443, 682 S.E.2d 545. "The instrument must give the right of forfeiture in terms so clear and explicit as to leave no room for any other construction." *Davis*, 205 Va. at 169, 135 S.E.2d 812. These canons of construction have great weight in the context of a no-contest provision in a trust instrument since a trust's very identity as a creature of equity presupposes the possibility of oversight of the trustee by a chancellor jealous of safeguarding the rights of all parties with an interest in the trust.
>
> Strictly construed, the proviso in the no-contest provision of the Theresa Trust does not equate a request for an *interpretation* of the trust's provisions with a *contest* of the trust. Instead, the no-contest provision enumerates the actions constituting a "contest" as "any action seeking to invalidate, nullify, set aside, render unenforceable, or otherwise avoid the effect of such instrument, action or transaction." J.A. at 255. These verbs — invalidate, nullify, set aside, render unenforceable, and avoid the effect of — are not synonyms for interpret.
>
> The proviso purports to remove an action (a request for judicial interpretation) from a list in which the action never appeared in the first place. The proviso states that Eleanor, as trustee, can agree that a request for an interpretation is not a contest. The proviso thus assumes that a request for an interpretation has already been defined as a "contest" by the no-contest clause — thus creating the need for a proviso that excises "interpretation" from that definition in certain circumstances. By doing so, the proviso makes a tautological assertion "in which the point to be proved is implicitly taken for granted," Black's Law Dictionary 189 (11th ed. 2019), a classic example of begging the question. One does not need an exception to a rule to do something the rule does not prohibit.
>
> For these reasons, the principles of strict construction dictate that neither the definition of "contest" nor the proviso's attempted exception from that definition clearly and unmistakably states that either count of Chip's declaratory judgment action violates the no-contest provision by seeking an interpretation of the trust and, based thereon, a declaration of the trustee's duties. The circuit court erred in concluding otherwise.

32. <u>**Settlement Agreement Among Trust Beneficiaries Void**</u>. <u>Roth v. Jelley</u>, 45 Cal.App.5th 655 (Ca.App. 2020), involved a settlement among some, but, crucially, not all of the trust beneficiaries. The opinion reviews the factual background:

> Petitioner Mark Roth (Mark) petitioned the probate court to be recognized as the beneficiary of a trust created by his grandfather pursuant to the default distribution provision of his grandfather' will. The probate court rejected the petition on the ground that an order made in the probate of the grandfather's estate in 1991 (which we refer to as the "1991 Decree") eliminated Mark's interest in the trust and was binding on him, even though he received no notice of the court proceeding that resulted in the 1991 Decree. This appeal presents the question whether Mark had a property interest in the testamentary trust created by his grandfather such that he had a due process right to notice and an opportunity to be heard before the probate court could enter the 1991 Decree that eliminated his interest in the trust.
>
> Mark's grandfather, McKie Roth Sr. (McKie Sr.) created a trust in his will for the benefit of his wife Yvonne Roth (Yvonne) during her life and granted her a testamentary power of appointment over the remainder. The will provided a default distribution scheme in case Yvonne did not exercise her appointment power, under which McKie Sr.'s three adult children from a prior marriage and

> the Yvonne's one adult son from a prior marriage would each take a one-quarter share of the remainder of the trust, with the proviso that, if an adult child did not survive Yvonne, then that child's surviving issue would take that child's share per stirpes. Thus, under the will, the issue of each of the four adult children had a contingent remainder interest in the trust, subject to divestment by Yvonne's exercise of her appointment power.
>
> When McKie Sr. died in 1988, his three adult children raised claims against their father McKie Sr.'s estate unrelated to the trust; they eventually settled their claims with McKie Sr.'s estate, Yvonne (his surviving wife), and the estate executor. One of the terms of the settlement was that the McKie Sr.'s three adult children disclaimed any interest in the trust.
>
> In 1991, the probate court issued a decree of final distribution of the McKie Sr.'s estate—the 1991 Decree—which included language changing the default distribution of the trust upon Yvonne's death, ostensibly based on the terms of the settlement. The 1991 Decree specified that the remainder of the trust was to be distributed solely to Yvonne's son or his surviving issue in case of default (i.e., failure of Yvonne to exercise her testamentary power of appointment). But McKie Sr.'s grandchildren (specifically, Mark and the other then-living issue of McKie Sr.'s three adult children) were not given prior notice of the 1991 decree, even though the decree *eliminated* their contingent interests in the remainder of the trust. Yvonne died in 2016 without having exercised her testamentary power of appointment.
>
> Mark's father McKie Roth Jr. (McKie Jr.) predeceased Yvonne. Mark petitioned the probate court to be recognized as a beneficiary of the trust pursuant to the default distribution provision of McKie Sr.'s will. He asserted the 1991 Decree was void because he never received notice of the proceeding that culminated in the 1991 decree.
>
> At the parties' agreement, the probate court decided the following dispositive issue in a bifurcated proceeding: was the 1991 Decree binding on the parties? The court determined the 1991 Decree was binding even though Mark received no prior notice because, in the court's view, Mark had no cognizable property interest in the trust.
>
> We conclude, however, that Mark did have a property interest in the trust in 1991 and that the 1991 Decree adversely affected his interest. Since it is not contested that Mark's existence and address were reasonably ascertainable at the time, due process required that Mark be given notice of the proceeding that resulted in the 1991 Decree and an opportunity to object. Because Mark was not given such notice, the 1991 Decree is void. Accordingly, we reverse.

[emphasis in original]

Why did the probate court believe Mark was not required to receive notice? Because Mark would not take unless at least two contingencies were met. The Court of Appeals summarizes Mark's interest as follows:

> Mark's property interest in the FYR Trust was contingent, not vested, because Mark would only take a share of the remainder if certain conditions precedent occurred: McKie Jr. had to predecease Yvonne ("not be then living" upon Yvonne's death) and Mark had to survive McKie Jr. ("leave issue surviving them"). Further, there had to be some balance left in the trust at its termination

> and Yvonne had to refrain from using her testamentary power of appointment. Mark's interest was future, not present, because he could only take a share of the remainder upon Yvonne's death in the future.

But reaches the opposite conclusion from the probate court:

> But we reject the probate court's determination that Mark "had no more than a unilateral expectation to a share of the [FYR] Trust." Mark had an actual property interest in the trust as set forth in the MWR Will. Mark's property interest was contingent and subject to divestiture if Yvonne exercised her testamentary power of appointment, but it was more than a "mere unilateral expectation" as claimed by respondents. First, "[t]he law has long recognized that a contingent future interest is property [citation] no matter how improbable the contingency" (*In re Marriage of Brown* (1976) 15 Cal.3d 838, 846, fn. 8, 126 Cal.Rptr. 633, 544 P.2d 561), and "a contingent remainder is an estate and not a mere expectancy" (*Estate of Zuber* (1956) 146 Cal.App.2d 584, 591, 304 P.2d 247). Second, takers in default (i.e., persons specified by a donor of a power of appointment to take property in default of the appointment) hold property interests even though "their interests are subject to complete divestment" through exercise of a power of appointment. (*Ammco Ornamental Iron, Inc. v. Wing* (1994) 26 Cal.App.4th 409, 418-419, 31 Cal.Rptr.2d 564 ["persons in existence, who are specifically designated in a trust instrument to take in default of the exercise of a power of appointment by the holder of the preceding estate, are beneficiaries of that trust and acquire vested remainder interests, although their interests are subject to complete divestment"]; see § 672, subd (a) ["if the powerholder of a discretionary power of appointment fails to appoint the property, releases the entire power, or makes an ineffective appointment, in whole or in part, the appointive property not effectively appointed passes to the person named by the donor as taker in default"].) Thus, Mark's contingent future interest in the remainder of the FYR Trust created by the MWR Will upon McKie Sr.'s death was a cognizable property interest, not a mere expectancy, and this property interest did not disappear simply because it was subject to complete divestment if Yvonne chose to exercise her testamentary power of appointment.

The existence of a property interest required notice be given to Mark. The opinion states:

> 1. Due Process Requires Reasonable Notice of Any Proceeding Adversely Affecting a Property Interest
>
> In 1950, the United States Supreme Court in *Mullane v. Central Hanover Bank & Trust Co*. (1950) 339 U.S. 306, 314, 70 S.Ct. 652, 94 L.Ed. 865 (*Mullane*) "recognized that prior to an action which will affect an interest in life, liberty, or property protected by the Due Process Clause of the Fourteenth Amendment, a State must provide 'notice reasonably calculated, under all circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections.' ... [T]he Court held that published notice of an action to settle the accounts of a common trust fund was not sufficient to inform beneficiaries of the trust whose names and addresses were known. The Court explained that notice by publication was not reasonably calculated to provide actual notice of the pending proceeding and was therefore inadequate to inform those who could be notified by more effective means such as personal service or mailed notice." (*Mennonite Bd. of Missions v. Adams* (1983) 462 U.S. 791, 795, 103 S.Ct. 2706, 77 L.Ed.2d 180 (*Mennonite*).)
>
> In *Mennonite*, the United States Supreme Court succinctly stated the rule, "Notice by mail or other means as certain to ensure actual notice is a minimum constitutional precondition to a proceeding which will adversely affect the liberty or property interests of *any* party ... if [that party's] name and address are reasonably ascertainable." (*Mennonite*, *supra*, 462 U.S. at p. 800, 103 S.Ct. 2706.)
>
> ***
>
> Because the 1991 Decree adversely affected Mark's property interest in the FYR Trust, he was entitled to notice by mail and an opportunity to be heard if his name and address were reasonably ascertainable. (*Mennonite*, *supra*, 462 U.S. at pp. 795, 800, 103 S.Ct. 2706.)
>
> At the time the 1991 Decree was adopted, Mark was McKie Jr.'s adult son and McKie Sr.'s grandson, and Jelley had apparently been dealing with disputes with McKie Jr. (and his siblings) for some years. It appears Jelley only had to ask McKie Jr. for the names and addresses of his existing children in order to provide Mark mailed notice. Mark has maintained below and on appeal that his existence and whereabouts were either known or reasonably ascertainable, and respondents do not contest this point. Under these circumstances, we conclude due process required that Mark be given mailed notice of the probate hearing that resulted in the 1991 Decree and an opportunity to object.
>
> Respondents claim that even if Mark had a property interest in the FYR Trust, *Mullane* does not require actual notice "given the remoteness of his interest." They rely on the *Mullane* court's observation, "Nor do we consider it unreasonable for the State to dispense with more certain notice to those beneficiaries whose interests are *either conjectural or future* or, although they could be discovered upon investigation, do not in due course of business come to knowledge of the common trustee." (*Mullane*, *supra*, 339 U.S. at p. 317, 70 S.Ct. 652, italics added.) They argue this observation shows Mark was not entitled to mailed notice. We are not persuaded.
>
> First, Mark's property interest in the FYR Trust was not conjectural. The MWR Will created a contingent future remainder interest in the trust. Second, we do not

read *Mullane* to mean due process notice requirements do not apply to holders of future property interests. In *Mullane*, the appellant was "appointed special guardian and attorney for all persons known or unknown not otherwise appearing who had *or might thereafter have* any interest in the income of the common trust fund." (*Mullane*, *supra*, 339 U.S. at p. 310, 70 S.Ct. 652, italics added.) In this context, when the court spoke of interests that were "future," it likely was referring to persons who did not currently have a property interest in the common fund but might acquire an interest in the future, not to beneficiaries who currently had future property interests in the fund. On the other hand, if the court did mean current beneficiaries with future interests were not entitled to mailed notice, the court may have determined that, because the common fund involved 113 trusts (*id*. at p. 309, 70 S.Ct. 652), it was too burdensome to expect the trustee to attempt to identify all current holders of future interests in the fund; but even if that was the court's reasoning, it would not apply here since it cannot be said in this case that it would have been burdensome for the trustee to ask the three adult children of McKie Sr. for the names and addresses of their own children. In any event, we do not think the *Mullane* court intended to *exclude* reasonably ascertainable holders of future property interests from due process considerations.

33. **Spousal Election And Revocable Trust – Indiana Law**. In In the Matter of the Revocable Trust Agreement Created by the Settlor, Anil Kumar Sarkar Dipa Sarkar, v. Anuradha ("Mili") Sarkar Naugle, ___ N.E.3d ___ (Ind. 2020), the issue presented was whether a surviving spouse can satisfy her election to take against the will of her deceased husband when he transferred the majority of his assets into a revocable trust. The trial court summarized the facts it thought were relevant as follows:

> 10. [ ] Anil's [T]rust was established in 1993, twenty-two (22) years prior to his death, for the purpose of obtaining assistance in personal and business affairs as well as disposing of his property at death. Anil had check writing authority on his [T]rust and could amend or modify it at any time. Both Anil and Dipa were present with [Attorney Lyman] when the original estate planning advice was provided. The couple agreed to dispose of their assets separately and not to each other. Dipa was aware of Anil's [T]rust and its provisions because it was identical to hers. Further, Anil and Dipa used a joint financial adviser, [ ], who testified that the couple's investments were identical. [The financial advisor] testified that Anil and Dipa came together to her office to execute financial documents and that each was aware of the others IRA and trust.
>
> 12. The [c]ourt finds no evidence that Anil's intent in creating the [T]rust was to frustrate Dipa's right to a statutory elective share. The [c]ourt further finds that Anil's [T]rust was not created in contemplation of his death and is therefore not testamentary. Therefore, the [c]ourt finds that Anil's [T]rust assets are not subject to Dipa's statutory elective share.

As stated, the trial court held the surviving spouse could not reach the revocable trust assets. The test in Indiana is intent: did the spouse fund the trust in contemplation of death to negate the other spouse's rights. The opinion reviews the precedent:

> Through *Leazenby v. Clinton Co. Bank & Trust*, 171 Ind.App. 243, 355 N.E.2d 861 (1976) and its progeny, Indiana precedents have shaped the conditions in which a surviving spouse may reach beyond the will into a valid *inter vivos* trust to satisfy the statutory elective right when faced with insufficient probate assets.

In *Leazenby*, we held that an *inter vivos* trust established by a wife successfully transferred her property and removed it from the estate, thereby in effect defeating her husband's interest in his statutory elective share. *Id.* at 866. We reached this conclusion by recognizing that a transfer solely for the purpose of defeating the spouse's statutory share is void. However, we found that wife and husband, a subsequent childless spouse, had maintained separate properties and that wife had gone to the bank to establish a trust for the purpose of obtaining aid in handling her affairs three years prior to her death. *Id.* at 862. The trust agreement reserved to the wife the right to income from the trust for life, the right to control the actions of the trustee, and the right to revoke. *Id.* Husband was granted the right to reside in the settlor's former house for six months following her death. *Id.* As time went on, wife was confined to a nursing home and her separate funds were used to pay for her care. *Id.* The *Leazenby* court observed that it was obvious husband was aware of this situation and had acceded to it. *Id.* at 866. There was no indication that it was the settlor's intent to use the device of a trust to defeat her husband's statutory share in her estate; rather, she had merely conveyed a portion of her estate during her lifetime, which she had every right to do. *See id.* at 866-67.

Approximately ten years later, in *Walker v. Lawson*, 526 N.E.2d 968, 969 (Ind. 1988), our supreme court was faced with the question of whether it was malpractice for an attorney to draft a will, and not a trust, for a client who had recently learned of a fatal diagnosis and who "had come [to the attorney] for the stated purpose of depriving her husband of any interest in her estate." Acknowledging both the rule set forth in *Leazenby* and the holding of *Crawfordsville Trust Co. v. Ramsey*, 55 Ind.App. 40, 100 N.E.1049 (1913), in which the court upheld the trial court's invalidation of assignments of stock and bonds by a spouse who made the assignments knowing he would soon die and for the sole purpose of defeating his spouse's elective rights with respect to the assigned property, the *Walker* court ruled that neither the conveyance of her land to a trust naming her children as beneficiaries nor a conveyance of that land to herself and her children with survivorship rights would have been effective against the surviving spouse's elective rights. *Id.*

Again after a ten-year interval, this court decided *Dunnewind*, 697 N.E.2d at 487, where we found in favor of the surviving spouse's right of election. Here, the settlor executed a will in 1976 in which she left all her assets to her children from a prior marriage. *Id.* at 487. After discovering she was terminally ill in 1995, she created a trust under which her husband would receive a life estate in the marital residence and household goods, as well as a predetermined sum of money, with the remainder to go to settlor's children. *Id.* The trust made no provision for payment of income to the settlor. Based on the evidence presented, the *Dunnewind* court opined that "there was no showing that the trust was executed to assist the [settlor] with business or financial affairs," and held that "the evidence presented at the hearing supports the trial court's findings that [the settlor] executed the trust in contemplation of her impending death and did so to defeat [husband's] statutory share ... Given such circumstances, the trust fails to defeat the spouse's share given the law announced in *Crawfordsville* and *Walker*." *Id.* at 487, 490. We also noted that the trust had a "testamentary character," because the trust agreement did not give the settlor a life interest in the trust property, yet the trustee, the settlor's daughter, permitted her to reside in the residential property and paid to her the trust's income until the settlor's death. *Id.* The court found that neither the settlor nor the beneficiaries intended the transfer to the trust to take effect until the settlor's death, similar to the finding in *Crawfordsville*. *Id.* at 490.

Finally, in *In re Estate of Weitzman*, 724 N.E.2d 1120, 1121 (Ind. Ct. App. 2000), both husband and wife had children from a prior marriage. Before the marriage,

> Wife refused to sign a prenuptial agreement that would have waived her elective share rights to her husband's estate. *Id.* Four years into the marriage, husband executed a revocable living trust, benefiting his children and appointing the bank as trustee while husband retained the power to direct all trust investment and receive the income from the trust. *Id.* Within three years, husband transferred significant assets into the trust. *Id.* Wife knew that husband had a trust; however, there was no evidence she was aware of the provisions of the trust. *Id.* at 1121-22. Husband died six years after creating the trust and several years after funding it. *Id.* After describing the nature and effect of an *inter vivos* trust and restating the general rule in *Leazenby* and the policy grounds upon which that decision was reached, the *Weitzman* court stated, "[t]here is one pertinent exception to the rules and policies we relied on in *Leazenby*. When a testator executes a trust in contemplation of his impending death and does so in order to defeat the surviving spouse's statutory share, the trust will be considered testamentary in nature and will not defeat the spouse's share." *Id.* at 1123. Finding that the facts did not negate the possibility that husband's intent was to defeat the surviving spouse's elective share, we reversed the trial court's summary judgment in favor of husband and remanded for trial. *Id.* at 1125.

The court affirmed stating:

> Accordingly, unlike *Weitzman*, where the wife knew that husband had a trust but was unfamiliar with its provisions, here, there is overwhelming evidence from which the trial court could have reasonably inferred that Anil and Dipa were aware of the other spouse's trust provisions and estate planning. *See In re Weitzman*, 724 N.E.2d at 1121. In fact, Anil and Dipa commenced their trust creation with the same attorney and although they later retained individual counsel, they were advised by the same financial planner, and had joint meetings in which their respective assets were discussed. Anil transferred his assets to the Trust with Dipa's full knowledge while at the same time she transferred her own assets to a nearly identical trust. As there is "no conclusive evidence that there was a secreting of the real ownership of the property, or that [Dipa] did not know and fully approve of the trust agreement," we conclude that Anil did not create the Trust with the intent to disinherit Dipa. *See Leazenby*, 355 N.E.2d at 866. Consequently, as there is substantial evidence that Anil did not create the Trust in contemplation of death and with the intent to disinherit Dipa, we affirm the trial court's decision to deny Dipa's claim to satisfy her spousal elective share from the Trust corpus.

34. <u>Duty to Consider Other Assets When Making Distribution</u>. Technically, <u>Matter of William J. Raggio Family Trust</u>, ____ P.3d ____ (Nv. 2020), was a discovery action but the substantive issue is fascinating. Widow was trustee and beneficiary of a marital trust and a bypass trust, which had different beneficiaries. She made distribution to herself from the marital trust that ultimately passed to her husband's family, as opposed to the bypass trust that passed to hers. The court approved that action. The opinion states:

> The narrow question before us is whether Dale, as trustee, has an obligation to consider other assets, including those in the Credit Shelter Trust, before making distributions to herself, as beneficiary, from the Marital Trust. We conclude she does not. NRS 163.4175 states, "[e]xcept as otherwise provided in the trust instrument, the trustee is not required to consider a beneficiary's assets or resources in determining whether to make a distribution of trust assets." Thus, Nevada trust law does not obligate a trustee to consider other assets or resources before making a distribution unless the trust instrument itself sets forth such a

requirement. Accordingly, to determine whether Dale has such an obligation, we must look to the language of the trust instrument.

Section 5.1 of the Marital Trust states, in relevant part, that the trustee "shall pay to or apply for the benefit of [Dale] as much of the principal of the Trust as the Trustee, in the Trustee's discretion, shall deem necessary for the proper support, care, and maintenance" of Dale. Both Dale and Righetti [remainderman of the marital trust] argue that the term "necessary" is the focal point for our inquiry, and they offer two conflicting interpretations of it. Dale interprets "necessary" as referring only to the *amount* of disbursement needed for her "proper support, care, and maintenance," without regard to her other assets. Righetti, on the other hand, interprets "necessary" as creating a threshold of *financial need.* Under this interpretation, Dale, as trustee, cannot distribute trust funds unless she can first show that without the trust distributions, she could not provide for her own "support, care, and maintenance." Righetti argues that the relevant discovery inquiry in determining whether a distribution is "necessary" to Dale is to determine what other financial means she has for her support, care, and maintenance.

The district court appears to have adopted Righetti's interpretation of "necessary," in that it creates a threshold of *financial need.* The district court determined that it "cannot determine what is necessary and proper without a complete understanding of the trustee's circumstances, to include standard of living and supportive resources beyond the marital deduction trust." We conclude that this determination was clearly erroneous for several reasons.

***

We thus conclude that the district court's interpretation is contrary to NRS 163.4175, which requires trustees to consider other assets only if the trust instrument itself invokes the exception. The district court should ***975** have begun its analysis from the position that Dale was not obligated to consider her other assets or resources before making a distribution unless the exception was invoked. Instead, the district court disregarded NRS 163.4175 and began evaluating whether one of William Raggio's "implicit intents was to preserve some trust corpus ... for the benefit of his two daughters and not exhaust the bypass trust in favor of preserving the credit shelter trust." NRS 163.4175 clearly provides that, if a settlor wants trustees to consider a beneficiary's other assets, the settlor must so state in the trust instrument. We cannot infer an exception to NRS 163.4175 based solely on the terms "necessary" and "proper" in the trust instrument, as those terms appear frequently in trusts but their meanings depend on the circumstances and text of the instruments. *See, e.g., Del Tr. Co.*, 95 A.2d at 47 (holding that "upon a full reading of the will in the light of the surrounding circumstances ... [the term "necessary" was] not language of condition[,] but [rather, was] language fixing the standard by which the trustee is to exercise its discretion in determining the amount to be spent"). Rather, it must be clear from the trust as a whole that the settlor's intent is to require the trustee to consider other assets. William Raggio did not express that intent.

Therefore, we conclude the district court erred as a matter of law in compelling discovery of the accounting and distributions of the Credit Shelter Trust. Neither NRS 163.4175 nor the Raggio Trust requires Dale to consider her other assets in making distributions from the Marital Trust, and thus, information about those assets is irrelevant.

35. Georgia Allows Beneficiaries To Amend Trust To Give Themselves The Power To Remove And Replace Trustees. Georgia has not adopted the Uniform Trust Code but has several provisions that are similar. The Beneficiaries of a trust may modify the trust if they all agree, the trustee receives notice, and a court finds no violation of a material purpose, and, if the settlor is dead. OCGA § 53-12-61(c)(1). There is also a trustee removal provision, OCGA § 53-12-221(a), that allows removal per the terms of the trust instrument, or upon petition to a court showing "good cause."

In Glass v. Faircloth, 840 S.E.2d 724 (Ga. App. 2020), the beneficiaries wanted to change trustees in a fee dispute. Interestingly, the court noted that because the beneficiaries could amend the trust under Georgia law, it did not have to grapple with whether the fees were in fact excessive. The court held that the two cited provisions were easily reconcilable:

> First, the Modification Statute operates, as here, only after the settlor's death (whereas the Removal Statute contains no such restriction), when concerns could arise that the settlor did not anticipate and can do nothing to resolve. Second, the Removal Statute, which operates at any time, allows initiation by "any interested person" and does not require consent of any of the beneficiaries. Thus, these two provisions address different scenarios and are not inherently inconsistent, and there is no ambiguity or practical effect that frustrates the purpose of either provision.
>
> ***
>
> Further, "[a]ll statutes are presumed to be enacted by the legislature with full knowledge of the existing condition of the law and with reference to it... [W]hen a statute is amended, from the addition of words it may be presumed that the legislature intended some change in the existing law." In light of this, when the legislature amended the Modification Statute in 2018 to allow trust modification after the death of the settlor (under the conditions enumerated in the statute), the legislature could have limited that authority with respect to removal of trustees. It did not. The Modification Statute instead contains broad authority to modify trusts after the death of the settlor so long as the court determines that the notice provisions are met, all beneficiaries consent, and the purpose of the trust is preserved. This is not an absurd or impracticable result, and it is not inconsistent with the ability to remove a trustee (without the consent of the beneficiaries) at any time due to misconduct or for other good cause. The Modification Statute, unlike the Removal Statute, does not contain a burden to show good cause and encompasses scenarios that do not involve trustee misconduct. In light of the plain statutory language requiring the court to approve a modification under the terms in the Modification Statute, we will not read into the Code a limitation that is absent.

36. **<u>Gift Causa Mortis</u>**. Sad circumstances produced a fascinating case in <u>In re Estate of Oaks</u>, ___ N.W.2d ___ (Wis. Ct. App. 2020). The facts were simple:

> Stouff and Oaks were in a romantic relationship for over twenty-three years—from February 1995 until Oaks' death on March 8, 2018. They never married, but they lived together for approximately ten years—from 2008 until Oaks' death. Oaks had been divorced twice and had an adult daughter, Cheri Wardell, who was not Stouff's offspring. It is undisputed that Oaks and Wardell did not have a "close relationship" and were "estranged for many years" prior to Oaks' death.
>
> In the early morning hours of March 8, 2018, Oaks fatally shot himself in the head in the home he shared with Stouff, while Stouff was asleep upstairs. Stouff woke when she heard a loud bang, and when she went downstairs to investigate, she found two handwritten notes on a table. The first note read:
>
>> 3-7-18
>>
>> Lynne Stouff has been my companion and my crutch for a long while.
>>
>> As I leave this existence I want all worldly belongings to be assigned to Lynne.
>>
>> David Oaks
>
> The second note read:
>
>> Lynne—
>>
>> This is all I can go with this—Thank you for being there for me all these years.
>>
>> I love you.
>
> It is undisputed that Oaks died intestate—that is, without a valid will. *See Intestate,* BLACK'S LAW DICTIONARY (11th ed. 2019). It is further undisputed that Oaks died unmarried and that Wardell was his only child. As such, Oaks' entire estate would normally pass to Wardell under the general rules of intestate succession, as set forth in WIS. STAT. § 852.01 (2017-18).

The question before the court was whether a suicide can give rise to gift causa mortis. The court held it could, reviewing authority going both ways from other jurisdictions:

> The Estate argues that Stouff cannot meet the second and third requirements for a gift causa mortis. It concedes Stouff can prove that Oaks gifted property to her in anticipation of his death. However, the Estate argues Stouff cannot prove Oaks gifted that property in anticipation of his death from a present illness or external peril because suicide is not a present illness or external peril. Further, because Oaks died as a result of suicide, the Estate argues he did not die from a present illness or external peril. For these reasons, the Estate contends a gift causa mortis can never occur in the context of a donor's suicide.
>
> While the Estate concedes that no Wisconsin case to date has addressed this issue, it asserts that "[h]istorically, the common law has maintained that a gift causa

mortis made in contemplation of the donor's suicide is void." The Estate further contends that various other jurisdictions have followed this historical rule and have held that "death by suicide does not satisfy the requirement that a gift be made in expectation of imminent death from illness or impending peril."

We do not find the Estate's argument in this regard persuasive. In making its argument, the Estate fails to distinguish between the manner of a donor's death and the ultimate cause of the donor's death. While the manner of death may be suicide, that suicide may, in some cases, have been caused by a present mental illness—for instance, depression. Accordingly, even in a case in which the donor died by suicide, a party may be able to show that the donor made a gift in expectation of his or her death from a present mental illness, and that the present mental illness caused the donor's death. Thus, contrary to the Estate's contention, the fact that a donor died by suicide does not automatically prevent a party from establishing that the donor made a gift causa mortis.

In support of its argument to the contrary, the Estate relies primarily on two cases from other jurisdictions—*Ray v. Leader Federal Savings & Loan Ass'n*, 40 Tenn.App. 625, 292 S.W.2d 458 (1953), and *Pikeville National Bank & Trust Co. v. Shirley*, 281 Ky. 150, 135 S.W.2d 426 (Ky. Ct. App. 1939). However, neither of those cases supports the Estate's argument that a gift causa mortis can never occur in the context of a donor's suicide.

In *Ray*, the Tennessee Court of Appeals was confronted with the following question when analyzing an alleged gift causa mortis: "Does death by contemplated suicide by a person who is presumed to be physically and mentally well, as in the instant case, arise from an apprehension due to a peculiar sickness, peril or danger?" *Ray*, 292 S.W.2d at 467. In answering that question, the court observed there was "nothing in the record to indicate that [the deceased] was not fully possessed of his mental faculties" at the time of his suicide. *Id.* On those facts, the court concluded that "[s]ickness, peril and danger, as used in definitions of [gifts] causa mortis ... mean something other than a determination of an individual who is presumed to be well, physically and mentally, to take his life." *Id.*

As the above excerpts make clear, *Ray* addressed whether a gift causa mortis could occur in circumstances where the donor was "presumed to be physically and mentally well" at the time of his suicide. *Id. Ray* did not address whether a gift causa mortis can occur when the donor's suicide was caused by a present mental illness. Accordingly, *Ray* does not compel a conclusion that a gift causa mortis can never occur when the donor died by suicide.

The Estate's reliance on *Pikeville National Bank* is similarly misplaced. In that case, the Kentucky Court of Appeals concluded certain gifts made before the donor's suicide did not qualify as gifts causa mortis "because vital and necessary elements [were] lacking, one of which is that such gifts must be made in expectation of imminent death from a disease or peril then impending." *Pikeville Nat'l Bank*, 135 S.W.2d at 429. The court reasoned:

> While it is alleged in the petition and admitted by answer that decedent was afflicted with tuberculosis, he did not die of that disease, but came to his death by self-destruction which the record indicates he had contemplated and determined upon several days before he carried his determined purpose into effect. Normal men are the arbiters of their own fate so far as suicide is concerned, since that is a matter within their own power of control.

Id.

The court in *Pikeville National Bank* considered a donor who had contemplated suicide for several days before making a decision to act. In addition, the court presumed that the donor was a "normal" man whose decision to end his life was a rational choice within his own power and control. As in *Ray*, the court did not consider a situation in which the donor died by suicide as a result of a present mental illness. For that reason, neither *Ray* nor *Pikeville National Bank* convinces us that a gift causa mortis can never occur in the context of a donor's suicide.[4]

We find more persuasive two cases from other jurisdictions, in which the courts concluded a gift causa mortis had occurred where the donor's suicide was the result of a present mental illness. In the first of those cases, the evidence showed that the donor was in "a serious state of mental depression" following his divorce. *In re Van Wormer's Estate*, 255 Mich. 399, 238 N.W. 210, 210-11 (1931). He told his mother that he was going to California to "go just as far away as he could from his troubles." *Id.* at 211. Before leaving, the donor purchased stock and directed that it be issued in his brother's name. *Id.* He then traveled to California, and while there he died by suicide. *Id.*

The Michigan Supreme Court concluded the donor's purchase of stock in his brother's name was a gift causa mortis. The court stated a gift causa mortis "cannot be sustained unless it appears from the record that at the time of the transaction the donor believed he was suffering from an affliction from which he might not recover and from which in fact he did not." *Id.* The court then concluded that requirement was satisfied in the case before it, explaining:

> The melancholia which evidently resulted in suicide had fastened itself upon [the] deceased before the date of the gift, and he obviously was convinced at that time that he could not continue on indefinitely in his depressed mental state. He attempted to travel away from his troubles. Weeks later he wrote, as quoted above, that he was then gradually getting a desire to want to live, and added in the same letter that he was then experiencing his first encouragement, and that he would probably return the middle of the summer, 'provided I meet with any measure of improvement.' The end a month later indicates he fought a losing fight. His gift made in contemplation should not be set aside.

Id. at 212.

The New Jersey Supreme Court reached a similar conclusion in *Scherer v. Hyland*, 75 N.J. 127, 380 A.2d 698 (1977). There, the donor was "acutely depressed" during the weeks leading up to her death by suicide. *Id.* at 699. Before her death, she left a note stating that she bequeathed all of her possessions to her romantic partner. *Id.* at 699-700. Under those circumstances, the court concluded the donor had made a gift causa mortis. The court expressly rejected the appellant's contention that suicide is "not the sort of peril that will sustain a gift causa mortis." *Id.* at 702. The court explained:

> While it is true that a gift causa mortis is made by the donor with a view to impending death, death is no less impending because of a resolve to commit suicide. Nor does that fixed purpose constitute any lesser or less imminent peril than does a ravaging disease. Indeed, given the despair sufficient to end it all, the peril attendant upon contemplated suicide may reasonably be viewed as even more imminent than that accompanying many illnesses which prove ultimately to be fatal. And, the notion that

> one in a state of mental depression serious enough to lead to suicide is somehow "freer" to renounce the depression and thus the danger than one suffering from a physical illness, although it has a certain augustinian appeal, has long since been replaced by more enlightened views of human psychology.

Id. (citations omitted).

Like the Michigan and New Jersey Supreme Courts, we conclude a gift causa mortis can occur in a case where the donor died by suicide as a result of a present mental illness. We therefore reject the Estate's assertion that a gift causa mortis can never be enforced in a case where the donor died by suicide.

The court concluded the decedent was a Vietnam veteran with PTSD who was depressed. The court also agreed that delivery occurred through the note:

> Just before ending his life, Oaks left a note on a table in the home he shared with Stouff directing that all of his "worldly belongings" should go to Stouff upon his death. Stouff was already in physical possession of the residence and all of the property inside it, and she had access to indicia of ownership for the rest of Oaks' belongings—i.e., keys to his vehicles, checkbooks, and bank account information. After leaving the note, Oaks fatally shot himself in the head while Stouff was asleep in the upper floor of their residence. Having been awoken by the gunshot, Stouff went downstairs and found the note on the table. We agree with Stouff that under these circumstances, "when Mr. Oaks left the note for Ms. Stouff on the table and when Ms. Stouff found the note, he completed delivery for the purpose of the gift causa mortis analysis." (Emphasis omitted.)
>
> Our supreme court's decision in *Sorenson* further supports this conclusion. In that case, the court affirmed a circuit court's finding that Edith Detjen had made a completed gift to Ann Friedmann of money in a bank account through the "symbolical delivery" to Friedmann of the account passbook. *Sorenson*, 34 Wis. 2d at 55-56, 148 N.W.2d 745. The evidence in *Sorenson* showed that Detjen, who had been hemorrhaging from the mouth, was waiting at home for an ambulance to take her to the hospital. *Id.* at 51, 148 N.W.2d 745. Two of her friends testified that while waiting for the ambulance, Detjen called Friedmann into the room and told Friedmann that "she was making a gift [to her] of the West Side Bank account and that she, Ann Friedmann, should withdraw the money." *Id.*
>
> The friends' testimony differed, however, regarding Detjen's delivery of the account passbook to Friedmann. One friend testified Detjen gave the passbook to Friedmann immediately after informing Friedmann of the gift. *Id.* The other friend testified that Detjen stated the passbook was in a box inside a dresser drawer, but the same friend later testified that she saw a book of the same color as Detjen's passbook in Friedmann's hands. *Id.* at 51-52, 148 N.W.2d 745. Friedmann testified Detjen had given her the passbook when the account was opened and it had been in Friedmann's possession ever since. *Id.* at 52, 148 N.W.2d 745. Our supreme court concluded these differences in the witnesses' testimony were "immaterial," explaining that "[p]roperty validly in the possession of the donee need not be returned to the donor so that it can be handed back to the donee." *Id.* at 55-56, 148 N.W.2d 745. In other words, the fact that Friedmann was—according to her own testimony—already in possession of the account passbook did not prevent Detjen from completing a valid delivery of the gift.

> Similarly, in this case, the fact that Stouff was already in possession of Oaks' property by virtue of their cohabitation did not prevent Oaks from making a valid delivery of his property to Stouff for purposes of the fourth requirement for a gift causa mortis. Instead, under the "relaxed rule" that applies when assessing the delivery of a gift between members of the same household, *see Potts*, 127 Wis. 2d at 54, 377 N.W.2d 204, we conclude Oaks delivered his property to Stouff by leaving a note informing her of the gift on a table in their shared residence, which he could be reasonably certain Stouff would find when she came downstairs.

37. **Parol Evidence Allowed In Virginia To Interpret Ambiguity**. The clause at issue in Larsen v. Stack, 842 S.E. 2d 372 (Va. 2020) read as follows:

> FIFTH: I devise the following described property to my children, namely, Pamela Larsen Stack and Kirk Larsen, subject to my wife, Sandra Flora Larsen, having the right to reside in our home located at 394 Mystic Lane, Wirtz, Virginia, 24184, for so long as she is physically and mentally able to do so, and for my wife, Sandra Flora Larsen to receive the monthly rental payments, as provided for in the PCS Site Agreement (Cell Tower), dated April 16, 2013, for as long as she resides in our home, it being all that certain tract or parcel of land (Tax Parcel #28-90) containing 101.39 acres, more or less, situated, lying, and being in the Gills Creek Magisterial District, Franklin County, Virginia, it being the same property conveyed to Erik Larsen, from James C. Ellis, by Deed dated February 7, 1972, said deed being of record in the Clerk's Office of the Circuit Court of Franklin County, Virginia, in Deed Book 277, at page 38.

A question was whether wife had a life estate in the property. The trial court allowed the decedent's lawyer to testify:

> The circuit court held a hearing regarding the declaratory judgment action on January 3, 2019. During the hearing, the circuit court determined that Erik's will did not clearly establish the scope of Sandra's interest in the house and farm. Consequently, the circuit court permitted W. Colby Brown, the attorney who drafted Erik's will, to testify.
>
> Brown testified that Erik intended for Sandra "to be able to stay on the property, and ... [receive] the money from the cell phone tower." However, Brown clarified that Erik "wanted his children to end up with the property." Brown explained that Erik did not give Sandra a life estate in the property because he was concerned that she would be required to sell such an interest before she could obtain Medicaid coverage.
>
> Brown believed that Erik intended for Sandra to have access to the entire farm as long she was physically and mentally able to reside in the house. Brown explained that "in the event that [Sandra] had to go into a nursing home basically, or ... couldn't live by herself anymore, something like that, then at that point her interest in the property would dissolve ... and then it would go to the children."
>
> At the conclusion of the hearing, the circuit court determined that Sandra did not have a life estate in the property. The circuit court explained that Erik's will gave Sandra the right to reside in Erik's house and the right to access the entire farm. The circuit court then noted that Sandra's rights were "subject to be terminated when she is no longer physically or mentally able to reside in the home."

With respect to the lawyer's testimony, the opinion states:

> Sandra contends that the circuit court erred by considering parol evidence when it construed the limitation that Erik's will placed on her right to reside on the property. Specifically, Sandra argues that the circuit court erred by considering Brown's testimony to determine that Sandra's interest in the property would end "in the event she had to go into a nursing home ... or couldn't live by herself anymore." Again, we disagree with Sandra's argument.
>
> As previously stated, parol evidence may be considered when the language of a will is ambiguous. *See Gaymon*, 258 Va. at 230, 519 S.E.2d 142. In such cases, "[p]arol evidence is admissible to enable the court to identify the property intended to be given by will, or to assist it in determining the quantum of interest which is to pass by the will." *Parsons v. Fitchett*, 148 Va. 322, 329, 138 S.E. 491 (1927) (quotation omitted).
>
> Erik's will was ambiguous in several ways. The will did not clearly define the scope of Sandra's right to reside on the property. Notably, the will failed to indicate whether Sandra had the right to access and enjoy the entire property, or whether she only had the right to live in Erik's house.
>
> The will was also ambiguous regarding the limitation that it placed on Sandra's rights. Pursuant to Erik's will, Sandra could reside on the property "for so long as she [was] physically and mentally able to do so." The will did not provide any further guidance concerning this limitation.
>
> Brown's testimony addressed the ambiguous provisions of Erik's will. Brown explained that Erik intended to give Sandra the right to reside on the entire property for as long she was physically and mentally able to live there. Brown then testified that Erik intended for Sandra's interest in the property to end "in the event that she had to go into a nursing home" or she "couldn't live by herself anymore."
>
> We conclude that Brown's testimony was necessary to resolve the ambiguities in the will. Brown's testimony explained Erik's intent regarding the scope of Sandra's rights and the limitation that Erik placed on those rights.
>
> Although Sandra contends that Brown's testimony impermissibly modified the terms of Erik's will, we find that Brown's testimony and the terms of the will were essentially consistent. We note that Erik's will only gave Sandra the right to reside on the property.
>
> Under these circumstances, we conclude that the circuit court did not err by considering Brown's testimony to determine the scope of Sandra's right to reside on the property and the limitation that the will placed on that right.

38. **Separation Agreement Anticipating Divorce Waives Intestate Rights**. In the Matter of Estate of Petelle, _________________________ (Wa. 2020), the parties entered into a separation agreement but husband died before the divorce was adjudicated. The question was whether the agreement waived wife's intestate rights. The majority held it did:

> In the contract, the parties agreed "to make a *complete and final settlement of all their marital and property rights* and obligations on the following terms and

> conditions." Clerk's Papers (CP) at 43 (emphasis added). The contract also provides that the "contract shall be final and binding upon the execution of both parties, whether or not a legal separation or decree of dissolution is obtained[,]" and, by its terms, the contract remained valid and enforceable against the **estate** of either party if either party died after the execution of the contract. CP at 43-44, 48. Though the contract contains a "Full Satisfaction of All Claims" section, the right to intestate succession is not mentioned. CP at 46.
>
> ***
>
> The Court of Appeals reasoned that "[t]his language is, arguably, sufficient to constitute waiver of all marital and property rights flowing from the marital relationship, including the right to intestate succession." *Petelle*, 8 Wash. App. 2d at 721. We agree. This provision is an express declaration to resolve "*all* marital and property rights," leaving no ambiguity that some or any marital or property rights remain unresolved. Our conclusion is further supported by a general purpose of separation contracts—to divide assets and liabilities in preparation for divorce.
>
> ***
>
> The fact that the right to intestate succession was not specifically mentioned in the contract does not limit the clear and explicit language providing the agreement is a complete and final settlement of all marital and property rights. The rights of a surviving spouse under RCW 11.04.015 flow from the marital status. Because the right to intestate succession is a result of the marital status, the right to intestate succession is similar to a marital or property right and we find the right is encompassed in this language.

Three of the nine justices dissented, in an interesting opinion which notes:

> In my view, the parties made their intent known. Michael and Michelle sought to accomplish the general purpose of separation contracts—dividing assets and liabilities in order to resolve the immediacy of their separation and possible divorce. They did not intend for the agreement to extend beyond those events. They understood that their divorce may not occur, in which case had a will been made, it would have had to state that Michelle was Michael's wife and that he specifically intended not to include her in the will. *In re Estate of Lindsay*, 91 Wash. App. 944, 949, 957 P.2d 818 (1998) ("A testator has the right to intentionally disinherit a surviving spouse."); *Strait v. Kennedy*, 103 Wash. App. 626, 634, 13 P.3d 671 (2000) ("[A] simple will or codicil to an earlier will stating that the testator intends to leave nothing to the spouse is sufficient [to disinherit a spouse]."). Specific language disinheriting a spouse is required in a will, and I see no reason why it should not be required in a separation contract. " '[W]here a person has the right to die intestate ... he is charged with full knowledge of who will succeed to his property if he dies intestate [and] the assumption exists that ... he is satisfied with the will the law of the state made for him.' " *Pitzer v. Union Bank of Cal.*, 141 Wash.2d 539, 550, 9 P.3d 805 (2000)(alterations in original) (quoting *Wilson v. Jones*, 281 S.C. 230, 233, 314 S.E.2d 341 (1984)) (discussing *Hesthagen v. Harby*, 78 Wash.2d 934, 481 P.2d 438 (1971)). Because Michael died intestate while married to Michelle, she was his surviving spouse and entitled to take under RCW 11.04.015(1)(c).
>
> I further disagree with the majority that the contractual language is broad enough to demonstrate Michelle knew she was waiving intestate inheritance

> rights. *See* majority at 851. The majority states that the rights of a surviving spouse flow from marital status, and so they are encompassed in the separation contract's statement resolving all marital rights. *Id*. But "[w]aiver is the intentional relinquishment of a *known* right." *Wagner v. Wagner*, 95 Wash.2d 94, 102, 621 P.2d 1279 (1980) (emphasis added). As noted above, there is no indication in the terms and conditions of the separation agreement indicating it extended to testamentary decisions, and I can find no authority from this court or from the legislature characterizing intestate inheritance rights as marital or property rights.
>
> Moreover, the rights of a surviving spouse include more than just dividing assets for dissolution of marriage. They include rights under the wrongful death statute, ch. 4.20 RCW; rights to Social Security survivor benefits; rights under the Employee Retirement Income Security Act, 29 U.S.C. 18; and the right to control the disposition of remains under RCW 68.50.160. Amicus Curiae Mem. in Supp. of Review at 6. Parties in separation and divorce proceedings are often unrepresented or have minimal access to legal assistance. *Id.* at 4-5. We should not assume, as the majority does, that pro se litigants in the past have comprehended the full legal consequence of agreeing to resolve all marital rights, especially considering the complexity of those rights. This result is even more concerning because the statute governing separation contracts, RCW 26.09.070(1), does not mention settling questions of inheritance. Just as we should not assume pro se litigants will recognize that intestate inheritance rights are encompassed in the terms marital and property rights when no prior authority has endorsed this holding, we should not assume these litigants intended to do something the statute does not mention.

39. **Attorney Insurance Policy Does Not Cover Attorney Acting as Trustee**. Philip Farthing, an attorney, was liable to the Higgerson beneficiaries of various family trusts of which he was trutee on account of his negligent investment of trust assets. Did his professional liability policy cover him? That was at issue in ALPS Property & Casualty Insurance Company v. Higgerson, 805 Fed.Appx. 193 (E.D. Va. 2020)(unpublished). The policy covered acting as a trustee but excluded negligent supervision of funds. The opinion states:

> Applying those standards, the court concluded that the policy exclusion for the "negligent supervision" of funds or property clearly and unambiguously applied, foreclosing coverage.[3] *Id.* at *6. Under that ***196** exclusion, the policy does not apply to any claim arising from or in connection with:
>
> > Any conversion, misappropriation, improper commingling or negligent supervision by any person of client or trust account funds or property, or funds or property of any other person held or controlled by an Insured in any capacity or under any authority, including any loss or reduction in value of such funds or property.
>
> J.A. 61–62. By its "clear and express terms," the district court found, that provision "facially applies" to stocks "held or controlled" by Farthing in "any capacity," including his capacity as trustee of the Higgerson family trusts. *ALPS*, 2018 WL 4927366, at *6.
>
> The district court acknowledged, as the Higgerson Defendants argued, that the phrase "negligent supervision" typically connotes "the supervision of other people," not funds or property. *Id.* at *7 n.10. But here, the court held, the context provided by the full provision – with its express reference to the "negligent supervision ... of client or trust account funds or property, or funds or property of

> any other person," J.A. 62 – "leaves no doubt that it excludes claims arising from the negligent supervision *of funds or property* held or controlled by the insured." *ALPS*, 2018 WL 4927366, at *7 n.10. Moreover, the district court reasoned, case law shows that "supervision" is commonly used to describe the management not only of people but also of investments, including stock portfolios. *Id.* at *7 (quoting, *e.g.*, *Migdal v. Rowe Price-Fleming Int'l, Inc.*, 248 F.3d 321, 324 (4th Cir. 2001) (noting that "[m]ost funds are externally managed – each fund contracts with an investment adviser to recommend *and supervise* the fund's investments") (emphasis added)). And all of that, the district court concluded, is consistent with the definition of "supervision" in Black's Law Dictionary – "[t]he series of acts involved in managing, directing, or overseeing persons or projects," *Supervision*, Black's Law Dictionary (10th ed. 2014) – on which Virginia courts have relied for the proposition that "supervision" may refer to the management or oversight of things (such as property) as well as people. *See ALPS*, 2018 WL 4927366, at *8 (citing *Hutton v. Commonwealth*, 66 Va.App. 714, 791 S.E.2d 750, 753 (2016)).
>
> It was equally clear, the district court held, that Farthing's conduct qualified as "negligent" within the meaning of the exclusion. There was no need to consider in this case the "precise contours of the ordinary meaning of the word 'negligence,' " the district court explained, because Farthing's investment activities were "expressly determined to be 'reckless' breaches of his fiduciary duties during the underlying state court lawsuit." *Id.* at *7. An insurer's duty to indemnify is governed by the plain terms of the policy and the "litigated facts" in the underlying state action, *id.* (quoting *CACI Int'1, Inc. v. St. Paul Fire & Marine Ins. Co.*, 566 F.3d 150, 155 (4th Cir. 2009)), and here, the prior finding of recklessness "establishes, as a matter of law, a lack of care that rises to, and exceeds, ordinary negligence," *id.*

40. <u>**Trusts Reformed to Avoid Reciprocity**</u>. In <u>Matter of Jill Petrie St. Clair Trust Reformation</u>**,** ___ P.3d ___ (Kan. 2020), spouses created trusts that were not intended to be reciprocal but the drafter omitted the relevant different provisions:

> In September 2003, Jill executed a trust agreement establishing the Jill Petrie St. Clair Trust. She named William J. Wallisch the trustee. The trust made her husband, William Paxson St. Clair, a life beneficiary of the trust's income. Upon William's death, the trust's income would then be distributed to Jill and William's children and grandchildren living at the time the trust was created, and the principal would eventually be distributed to the grandchildren or their estates.
>
> In December 2002, before Jill created her trust, William established his own trust with an identical distribution scheme but naming Jill a life beneficiary of the trust's income. Both Jill and William funded their trusts in identical amounts when Jill executed her trust agreement.
>
> M. Wayne Davidson was the attorney who prepared the trusts for Jill and William. One of the purposes of William's trust was to make sure the assets in his trust were not included in his or Jill's taxable estates. Davidson proposed to Jill that she create her own trust to obtain gift tax benefits and to similarly assure that the assets in her trust were not included in William's taxable estate. Davidson drafted Jill's trust with those objectives in mind. To that end, Jill's trust agreement provided that "no part of this Trust shall be included in the Grantor's gross estate for death tax purposes." At the time Jill executed the trust agreement, she believed it contained the necessary provisions for the trust assets to be excluded from her and

> William's taxable estates, and for the transfers to the trust to be considered completed gifts.
>
> But because of a drafting error, Davidson failed to include two provisions necessary to differentiate the benefits provided to William under Jill's trust from the benefits provided to Jill under William's trust. These provisions were necessary to avoid the two trust being considered reciprocal, resulting in the assets of Jill's trust being included in William's estate upon his demise and vice versa. One of the provisions that was erroneously omitted from Jill's trust agreement would have enabled William to annually receive $5,000 or 5% of the assets in Jill's trust. The other provision would have given William a lifetime special power of appointment over the trust assets in Jill's trust that would have enabled him to appoint all or any portion of the assets in Jill's estate to any person other than himself, his creditors, his estate, or the creditors of his estate. These provisions are commonly used by attorneys drafting trusts to avoid creating reciprocal trusts.

The trial court found that the scrivener had committed an error which the Kansas Supreme Court affirmed.

41. Ethical Obligation To Avoid Counseling Or Assisting A Client In A Criminal Or Fraudulent Situation. On April 29, 2020, the American Bar Association issued Formal Opinion 491. As background for the opinion, it notes:

> In the wake of media reports,[2] disciplinary proceedings,[3] criminal prosecutions,[4] and reports on international counter-terrorism enforcement and efforts to combat money-laundering, the legal profession has become increasingly alert to the risk that a client or prospective client[5] might try to retain a lawyer for a transaction or other non-litigation matter that could be legitimate but which further inquiry would reveal to be criminal or fraudulent.[6] For example, a client might seek legal assistance for a series of purchases and sales of properties that will be used to launder money. Or a client might propose an all-cash deal in large amounts and ask that the proceeds be deposited in a bank located in a jurisdiction where transactions of this kind are commonly used to conceal terrorist financing or other illegal activities.[7] On the other hand, further inquiry may dispel the lawyer's concerns.

[footnotes omitted]

The substance relevant to estate planners is as follows:

> As set forth in Section II of this opinion, a lawyer who has knowledge of facts that create a high probability that a client is seeking the lawyer's services in a transaction to further criminal or fraudulent activity has a duty to inquire further to avoid assisting that activity under Rule 1.2(d). Failure to make a reasonable inquiry is willful blindness punishable under the actual knowledge standard of the Rule. Whether the facts known to the lawyer require further inquiry will depend on the circumstances. As discussed in Section III, even where Rule 1.2(d) does not require further inquiry, other Rules may. These Rules include the duty of competence under Rule 1.1, the duty of diligence under Rule 1.3, the duty of communication under Rule 1.4, the duty to protect the best interests of an organizational client under Rule 1.13, the duties of honesty and integrity under Rules 8.4(b) and (c), and the duty to withdraw under Rule 1.16(a). Further inquiry under these Rules serves important ends. It ensures that the lawyer is in a position to provide the informed advice and assistance to which the client is entitled, that the representation will not result in professional misconduct, and that the representation will not involve counseling or assisting a crime or fraud. Section IV addresses a lawyer's obligations in responding to a client who either agrees or does not agree to provide information necessary to satisfy the duty to inquire. Finally, Section V examines hypothetical scenarios in which the duty to inquire would be triggered, as well as instances in which it would not.

The opinion contains five examples, three of which easily could be directly relevant to an estate planner:

> #3: A general practitioner in rural North Dakota receives a call from a long-term client asking her to form a limited liability company for the purpose of buying a ranch.[52]
>
> #4: The general practitioner in rural North Dakota receives a call from a new and unknown prospective client saying that the client just won several million dollars in Las Vegas and needs the lawyer to form a limited liability company to buy a ranch.[53]
>
> #5: A prospective client in New York City asks a general practitioner in a mid-size town in rural Georgia to provide legal services for the acquisition of several farms in rural Georgia. The prospective client tells the lawyer that he has made a lot of money in hedge funds and now wants to diversify his investments by purchasing these farms but says he doesn't want his purchases to cause a wave of land speculation and artificially inflate local prices. He wants to wire money into the law firm's trust account over time for the purchases. He asks the lawyer to create a series of LLCs to make strategic (and apparently unrelated) acquisitions.[54]

[footnotes omitted]

The opinion provides no discussion beyond references to the Am. Bar Ass'n Task Force On Gatekeeper Regulation And The Profession, Voluntary Good Practices Guidance For Lawyers To Detect And Combat Money Laundering And Terrorist Financing.

42. **No-Contest Clause Applied**. Missouri has a statute allowing a "test" lawsuit over a no-contest clause. In Knopik v. Shelby Investments, LLC, 597 S.W.3d 189 (Mo. 2020), the beneficiary ignored that statute and just filed a lawsuit alleging a breach by the trustee. The court applied the no-contest clause:

Gift L.L.C. ("Settlor") created the Knopik Irrevocable Trust ("Trust") in late December 2016. The provisions of the Trust established Shelby Investments, L.L.C. ("Trustee") as the sole trustee and Samuel Knopik ("Beneficiary") as the sole beneficiary of the Trust. The Trust was to provide the Beneficiary with a \$100-per-month distribution, beginning in December 2016 and ending in December 2020. Provision 12 of the Trust, denominated "No Contest," provided:

> In case any beneficiary shall (i) contest the validity of this trust, or any provisions hereof, in whole or in part; (ii) make a claim against a trustee for maladministration or breach of trust; or (iii) attempt to remove a trustee for any reason, with or without cause; then such contest or claim and such attempt shall cancel and terminate all provisions for or in favor of the beneficiary making or inciting such contest or claim, without regard to whether such contest or claim shall succeed or not; and all and any provisions or provision herein in favor of the beneficiary so making such contest or claim, or attempting or inciting the same, to be revoked and of no force and effect; and the entire trust estate shall revert to the Settlor and be distributed to the Settlor.

The Trustee made a single distribution to the Beneficiary in February 2017 but made no further distributions pursuant to the terms of the Trust. In August 2017, the Beneficiary filed a petition against the Trustee for breach of trust and to remove the Trustee. The Trustee admitted it made the single payment pursuant to the Trust, despite additional distributions being required. The Trustee further admitted it had indicated to the Beneficiary that it did not intend to make any future payments pursuant to the Trust. The Trustee also raised a counterclaim for declaratory judgment, asking the circuit court to determine that, due to the violation of the "No Contest" provision of the Trust, all provisions of the Trust in favor of the Beneficiary were cancelled and terminated. The Beneficiary and the Trustee each filed motions for summary judgment. The circuit court entered summary judgment in favor of the Trustee on its counterclaim after finding that the Beneficiary's filing of his petition for breach of trust and removal violated the Trust's no-contest clause. The Beneficiary appeals.

***

There is no doubt that the language of the Trust indicated the Settlor's clear intent to impose the result of forfeiture when the Beneficiary filed his petition. Provision 12 of the Trust purported to require forfeiture if the Beneficiary were to contest the validity of the Trust, make a claim against the Trustee for maladministration or breach of trust, or attempt to remove the Trustee for any reason. The petition the Beneficiary filed in the circuit court contained two counts. Count I was titled "Breach of Trust." Count II – "Removal" – sought removal of the Trustee and proposed a replacement trustee. When the Beneficiary filed his petition, violation of the plain language of Provision 12 was evident. The circuit court found the filing of the petition, as pleaded, to be in violation of the Trust's no-contest provision, and the circuit court ordered that all provisions of the Trust in favor of the Beneficiary be cancelled and terminated. The Beneficiary asks for relief by having this Court rule that no-contest clauses are inapplicable when the action is for breach of trust or removal of a trustee.

However, if the Beneficiary wished to challenge the enforceability and applicability of the no-contest clause to the claims in his petition, he should have done so in a proceeding under section 456.4-420. Section 456.4-420, enacted by the Missouri legislature in 2014, addresses a procedure by which an interested person can seek to avoid the effect of no-contest clauses in trusts. The statute

> provides "for an interlocutory determination whether a particular ... petition ... by the interested person would trigger application of the no-contest clause or would otherwise trigger a forfeiture that is enforceable under applicable law and public policy." Section 456.4-420.1. Upon consideration of the language of the clause, the relationship of the clause to the trust instrument, and the facts of the petition, the circuit court makes a determination that "result[s] in the no-contest clause being enforceable to the extent of the court's ruling." Section 456.4-420.4. This determination is subject to appeal. Section 456.4-420.3.
>
> Section 456.4-420 provided a "safe harbor" in which the Beneficiary should have invoked a challenge to the enforceability and applicability of the no-contest clause to his claims for breach of trust and removal. But the Beneficiary chose to file his petition asserting the exact claims the Trust unambiguously stated would result in forfeiture. Because of the Beneficiary's failure to utilize section 456.4-420, this Court need not reach the issue of either delineating specific exceptions to the application of no-contest clauses or deciding whether a good faith or probable cause exception should be introduced in Missouri.

The court seems to base this tough result for the beneficiary on the beneficiary's failure to start with a different statute, but suppose the beneficiary had asked the clause would apply and the court had said yes? The beneficiary would have been without a remedy. Why Missouri would enforce a trust with so few – maybe no – limits on a trustee is uncertain. A concurrence hints of a backstory that reflects poorly on the court and litigants:

> It has been suggested that the present case is fictitious or collusive. *See* Kimberly E. Cohen, et al. *Advanced Estate Planning Practice Update: Summer 2019* (American Law Institute June 12, 2019) (quoted portion authored by Kathleen R. Sherby) (setting forth the circumstances surrounding this case and concluding: "Based on the circumstantial evidence gathered thus far, *Knopik* appears to be a 'contrived' case, put together by the two disappointed lawyers in [a prior matter]."). The author of this suggestion makes a compelling case but uses facts and inferences both within and outside the record now before this Court. This Court, on the other hand, has authority to dismiss an appeal on the ground that the case is fictitious or collusive only if the record before the Court demonstrates this is so. *State ex rel. Chandler v. McQuillin*, 229 Mo. 523, 130 S.W. 9, 12 (Mo. 1910); *Hahn*, 36 S.W. at 665-66. Here, the record falls short of that standard, and the Court declines to inquire of the parties and their counsel further on this issue.
>
> It is devoutly to be hoped, however, that this case – and the ramifications and remedies that will flow from the pursuit of a fictitious or collusive suit, though they were not invoked here – come to mind the next time counsel or their clients consider feigning a dispute (or the appearance of one) merely for the purpose of securing an advisory opinion.

PART 5 - 2020 KENTUCKY LEGISLATIVE CHANGES

Appreciation is given to Beth Anderson, Emmy Daunhauer, Kelly Henry, and Walter Morris, each of Wyatt, Tarrant & Combs, LLP, for their summaries of these various acts.

1. Kentucky Community Property Trusts.

House bill 155, adopted by the 2020 regular session of the Kentucky legislature and signed by the governor on March 17, 2020, authorizes the creation of "community property trusts." Assets contributed by the settlor spouses to such a trust are declared to be "community property." The potential benefit of a community property trust is a new cost basis for federal income tax purposes for all property held by the trust at the death of the first spouse.

Section 1014(b)(6) of the Internal Revenue Code provides that the surviving spouse's one-half share of community property "held by the decedent and the surviving spouse under the community property laws of any State" shall be deemed to have been "acquired from or to have passed from the decedent." Under IRC § 1041(a), property acquired from a decedent takes a new basis equal to its fair market value on the date of the decedent's death. This change in basis occurs even though the surviving spouse's share of the community property is not included in the decedent's estate for federal estate tax purposes. The decedent's one-half share of community property is, of course, included in the decedent's estate for federal estate tax purposes and also takes a new basis equal to its fair market value on the date of the decedent's death. In short, all property held by a community property trust appears to get a new cost basis for federal income tax purposes upon the death of the first spouse.

Federal Income Tax Law and Elective Community Property. Kentucky is a common law state, not a community property state. That being the case, can property held by a Kentucky community property trust take advantage of IRC § 1014(b)(6) so as to get a new basis for all property held by the trust at the death of the first spouse? Alaska was the first state to adopt a statute enabling persons living in a common law state to elect into community property status for specifically identified property. The Alaska statute was adopted in 1998. It was followed by Tennessee in 2010 and South Dakota in 2016. To date, no rulings or cases have addressed whether these statues "work" to provide a double basis step up for elective community property at the death of the first spouse. The absence of rulings or cases for 22 years is some indication that the IRS views property held in such arrangements as entitled to the benefit provided by IRC 1014(b)(6).

Section 25.18.1.2.2(2) of the Internal Revenue Manual comments on the Alaska statute as follows:

> The U.S. Supreme Court ruled that a similar statute allowing spouses to elect a community property system under Oklahoma law would not be recognized for federal income tax reporting purposes. Commissioner v. Harmon, 323 U.S. 44 (1944). The Harmon decision should also apply to the Alaska system for income reporting purposes.

The Harmon case involved an elective community property law adopted by Oklahoma and was decided prior to the enactment of IRC § 6013(a) authorizing married persons to file joint income tax returns. The Supreme Court refused to recognize the Oklahoma statute for income tax reporting purposes on the ground that it constituted an "assignment of income." Assignments of income are not recognized for federal tax purposes.

Washington is a community property state. In Rev. Rul 77-359, the Service considered the effect for federal tax purposes of a Washington statute that allowed married couples by agreement to convert their separate property to community property. The Service held that property subject to the agreement would be "community property" but that "to the extent that the agreement affects the income from separate property and not the separate property itself, the Service will not permit the spouses to split that income for Federal income tax purposes where they file separate income tax returns." The effect of the ruling was that the spouse contributing the more valuable separate property to the arrangement made a gift to the other spouse for federal gift tax purposes equal to the difference in value of the two contributed shares. Based on this ruling, it would appear that a Kentucky community property trust would be recognized for purposes of IRC § 1014(b)(6), even if it were not recognized for income tax reporting purposes if the spouses filed separate returns. The gift occurring if the spouses do not contribute equal amounts of property would need to qualify for the gift tax marital deduction. This could be accomplished by the trust agreement authorizing each spouse to withdraw that spouse's one-half share of the trust's accounting income and by providing that each spouse has the right to require the trustee to make the trust property income producing. The gift should then qualify for the gift tax marital deduction under IRC § 2523(e) as a "life estate with power of appointment" trust. See Section 2(3) of HB 155 which provides that each spouse may amend a community property trust regarding the disposition of that spouse's one-half share of the community property in the event of a spouse's death. Alternatively, the couple's separate property could first be converted to equal tenancy in common property or joint tenancy with right of survivorship and then contributed to the trust thereby avoiding the gift issue entirely.

Community Property Trusts and Kentucky Income Tax. HB 155 made an amendment to KRS 141.019(1) by adding a new subparagraph (o) which provides that the basis change to the surviving spouse's share of a Kentucky community property trust for federal income tax purposes will be ignored for Kentucky income tax purposes. This provision made HB 155 revenue neutral for Kentucky purposes.

Effective Date. HB 155 will be effective 90 days following the close of the current session of the legislature, with July 15, 2020 the likely effective date.

Requirements for Creating a Kentucky Community Property Trust. The requirements for creating a Kentucky community property trust are:

- A married couple must contribute property to a trust governed by a trust agreement that expressly declares it to be a Kentucky community property trust;
- The trustee of the trust must be a "qualified trustee", i.e., a natural person who is a Kentucky resident or a bank or trust company authorized to act as a trustee in Kentucky whose duties include maintaining records for the trust and preparing or arranging for the preparation of income tax returns for the trust. The statute states that both spouses or either spouse may be a trustee;
- The trust must contain a statement at the beginning of the document in capital letters warning that the trust changes the couple's rights with respect to the property contributed to the trust. The required statement is as follows:

> THE CONSEQUENCES OF THIS TRUST MAY BE VERY EXTENSIVE, INCLUDING BUT NOT LIMITED TO YOUR RIGHTS WITH YOUR SPOUSE BOTH DURING THE COURSE OF

YOUR MARRIAGE AND AT THE TIME OF A DIVORCE. ACCORDINGLY, THIS AGREEMENT SHOULD ONLY BE SIGNED AFTER CAREFUL CONSIDERATION. IF YOU HAVE ANY QUESTIONS ABOUT THIS AGREEMENT, YOU SHOULD SEEK COMPETENT ADVICE.

- The trust agreement must be signed by both spouses.

Unlike the Alaska statute, HB 155 does not require financial disclosure when establishing a community property trust. Perhaps none is required as long as the trust agreement adheres to an equal ownership interest by each spouse in the trust's assets. That said, consideration should be given to providing financial disclosure when establishing a community property trust. Arguably, one effect of creating a community property trust is that all property placed in the trust is divided equally in the event of a divorce as if each spouse has made a gift to the other spouse's separate estate. If so, that is certainly a change in the property's status that would argue in favor of financial disclosure when entering into the arrangement.

Rights of Settlor Spouses and Third Parties in Property Held by a Community Property Trust. Section 2(7) of HB 155 provides that "all property owned by a community property trust shall be considered community property during the marriage and the right to manage and control property that is transferred to a community property trust shall be determined by the terms of the trust." Once distributed out of a community property trust, property ceases to be community property. HB 155, Section 2(8). The declaration that property held by the trust is community property is helpful, but when drafting a community property trust prudence suggests including provisions that mimic traditional community property. One of the hallmarks of community property is a vested interest in each spouse in an undivided one-half interest in the property during life. This contrasts with common law states in which dower and curtesy rights generally vest only at the death of the first spouse. As a result of this vested interest, in most community property states each spouse has an equal right to enjoy the entirety of community property and equal management rights with respect to it. Moreover, community property states typically do not have spousal election statutes. In addition, in most community property states either spouse may act alone in the management of community property, including borrowing on behalf of the community. However, a gift or sale of community property will require the consent of both spouses. To the extent feasible, a community property trust agreement should provide for these classic characteristics, particularly the right of each spouse to use and enjoy all of the property held by the trust, to receive one-half of the income from the property, and to receive one-half of the value of each asset (or equivalent value) in the event property is distributed from the trust in kind or the trust terminates other than by death or divorce.

HB 155, section 3(3), contains a default rule that upon the death of the first spouse, one-half of the aggregate value of the property owned by the trust "shall reflect the share of the surviving spouse and the other one-half shall reflect the share of the decedent." Section 2(3) says that either spouse may amend a community property trust regarding the disposition of that spouse's one-half share of the property in the event of the spouse's death. The trust agreement is otherwise irrevocable unless a power of amendment or revocation is reserved in the instrument. The statute doesn't address how the property will be apportioned between the spouses in the event of a distribution of property from the trust except in the event of divorce, in which case the trust terminates and the trustee is to distribute one-half of the trust assets to each spouse, with each spouse receiving one-half of each asset unless otherwise agreed in writing by both spouses.

Section 2(2) of HB 155 gives spouses creating a community property trust considerable latitude in drafting the terms of the trust, including their rights and obligations with respect to the property and its management and control. The bill as drafted was intended to overrule any trust provision that altered the ability of the first spouse to die to dispose of one-half of the trust at that spouse's death. Due to a drafting error the cross reference that implemented that provision refers to the wrong section of the bill. Regardless of this glitch, a community property trust agreement should give the first spouse to die the ability to dispose of one-half of the trust property as the right to do so is one of the fundamental hallmarks of community property.

Section 2(6) of HB 155 says that a community property trust is enforceable without consideration.

Section 3, subsections (1) and (2), of HB 155 address the rights of creditors to reach property held by a community property trust. An obligation incurred by one spouse before marriage may be satisfied from that spouse's one-half share of a community property trust and an obligation incurred by both spouses during the marriage may be satisfied from "the community property trust of the spouses."

<u>Drafting a Community Property Trust</u>. Section 2(4) of HB 155 provides that a community property trust is irrevocable unless the trust agreement provides otherwise. This default rule is likely to be overridden in most cases to the extent of providing that the trust can be amended and property withdrawn from the trust with the consent of both spouses. There would seem to be no reason in most cases to make the trust irrevocable as no tax or creditor protection benefit would result from doing so. Upon the death of the first spouse, if that spouse's share of the trust remained in further trust such trust would be irrevocable and the trust would then function as a joint revocable trust. In that case, the community property trust agreement would follow the approach of a typical revocable trust, with in most cases a gift of the share of the first spouse to die outright to, or in trust for, the surviving spouse followed by a disposition at the death of the survivor of the remainder interest. The surviving spouse would be given the right to remove that spouse's one-half share of the trust property following the death of the first spouse and a gift over if the property is not withdrawn.

<u>Likely Users of Community Property Trusts</u>. Candidates for a community property trust are persons in long term first marriages who hold appreciated assets. Younger couples with appreciated assets may find the need to distribute assets from the trust to the parties in equal shares in the event of a divorce a possible downside to the arrangement by making it harder to argue that marital property should be divided unequally. Assets that decline in value below their cost basis will take a double step down in basis at the death of the first spouse which can be viewed as a possible risk of creating such a trust. However, many older couples may find the benefits of a community property trust appealing as compared with holding assets as joint tenants with right of survivorship.

2. <u>Amendment to the Rule Against Perpetuities to Facilitate the Delaware Tax Trap</u>.

KRS 381.225 through KRS 381.226 contains Kentucky's "Rule Against Perpetuities." The general rule provided by these statutes is that vesting of interests in a trust may be suspended indefinitely, but the trustee's power to "alienate", i.e., sell, trust property can only be suspended for a period measured by the lives of persons in being at the time the trust became irrevocable, plus 21 years. KRS 381.225. HB 154, also enacted by the 2020 regular session of the legislature, amends KRS 381.225(1)(c) to provide that the permissible period for suspending the power to alienate trust assets with respect to a future interest in trust created by the exercise of a non-general power of appointment will be computed from the date of the exercise of the power if the instrument exercising the power so provides. In such case the so called "Delaware tax trap" is arguably sprung triggering inclusion of the assets subject to the power in the gross estate of the person exercising it. IRC § 2041(a)(3). Such inclusion provides a new basis for the assets equal to their fair market value on the date of the decedent's death. IRC § 1014(b)(9). An advantage of this approach is that it doesn't require granting anyone a power to appoint to the creditors of their estate. The actual operation of a power to appoint to creditors is uncertain. For example, if a creditor is owed $10,000 may the power holder appoint the whole of a $1 million trust to that creditor? Or is the power holder limited to an appointment of $10,000? There is no authority on the question. Nor does an independent person need become involved to consent to the granting of the power to block an inappropriate exercise. The downside of using KRS 381.225(1)(c) for this purpose is a lack of authority specifically confirming its effectiveness. For further discussion of this subject see Raatz, "'Delaware Tax Trap' Opens Door to Higher Basis for Trust Assets," Estate Planning (February 2014 - Volume 41 Number 2)

3. Amendment to Kentucky's Decanting Statute.

Section 6 of HB 155 amends KRS 386.175, Kentucky's "decanting" statute. Specifically, KRS 386.175(2) is amended to provide that a decanting can be accomplished by an amendment to the terms of the original trust agreement. In light of this amendment, a decanting can be accomplished without distributing assets from the original trust to a new trust. Subject to further guidance by the IRS, decanting by an amendment may mean that the second trust is a mere continuation of the original trust and not a termination thereby retaining the tax attributes of the original trust and avoiding the need to obtain a new taxpayer identification number.

4. **Kentucky's Uniform Power of Attorney Act**.

Introduction

The Uniform Power of Attorney Act (the "Act") is comprised of four articles – general provisions, authority, statutory forms and miscellaneous. The first article contains the general provisions about creation and use of a power of attorney and certain mandatory provisions to safeguard and protect the principal, the agent, and the persons asked to rely on the agent's authority. Article 2 defines the authority that can be granted to an agent, and provides for general powers and enhanced or special powers that are thought to have higher risk associated with granting them to an agent. Article 3 contains an optional statutory form and sample agent certification form. Article 4 contains miscellaneous provisions setting out the effective date of the Act and the relationship of the Act to other law and to pre-existing powers of attorney.

In 2018, Kentucky enacted Article 1 and 4 of the Act as Chapter 457, and by amendment to 20 HB 154, Articles 2 and 3 were enacted. Twenty-eight States have enacted the Act. In 2020, four States, Kentucky, Massachusetts, South Dakota and Tennessee as well as the District of Columbia introduced the Act with South Dakota and Kentucky successfully enacting it.

Article 1 – General Provisions

- HB 154 made two amendments to the general provisions under Chapter 457.

  §457.030 was amended to exempt powers of attorneys related to the transfer of motor vehicles from the Act.

  The Act does not apply to a power granted to a motor vehicle dealer licensed pursuant to KRS 190.030 and authorized insurers or their agents for the purpose of facilitating the transfer of ownership or title to a motor vehicle, regardless of whether such power is an original, photocopy, or facsimile.

  Eight types of powers of attorney are now exempt from the Act.

- §457.050 was amended to remove the two witness signing requirement.

  A power of attorney shall be signed by the principal.

  Deleted "in the presence of two disinterested witnesses."

  Retained the presumption of a genuine signature if the signature is notarized.

  Neither notary or witnesses are required to create a valid power of attorney.

- §457.200 was not amended with the enactment of the statutory forms.

  The Uniform Act has two alternative provisions regarding liability for refusing to accept a power of attorney.

  In 2018, Kentucky enacted the version that applies to all "acknowledged powers of attorney."

  In 2020, Kentucky could have amended §457.200 (but did not) to limit liability to only refusals of statutory form powers of attorney.

  This could be construed as a policy stance to continue to allow all forms of powers of attorney and not require the statutory form.

<u>Article 2 – Authority</u>

HB 154, Sections 43 to 59, enacted nearly verbatim Article 2 of the Act.

Specific Grant of Authority.

HB 154, Section 43 sets out the powers which both must be expressly granted within the power of the attorney and not otherwise prohibited by another agreement:

create, amend, revoke, or terminate an inter vivos trust;

make a gift;

create or change rights of survivorship;

create or change a beneficiary designation;

delegate authority granted under the power of attorney;

waive the principal's right to be a beneficiary of a joint and survivor annuity, including a survivor benefit under a retirement plan;

exercise fiduciary powers that the principal has authority to delegate; or

exercise authority over the content of electronic communications, as defined in 18 U.S.C. Section 2510(12), as amended, sent or received by the principal.

A principal may grant broad general authority to their agents and doing so grants the agent all of the authority defined in HB 154, Sections 46 to 58.

Gifting is generally limited to annual exclusion gifts – see HB 154, Section 59.

HB 154, Section 44, provides that the principal may incorporate the general powers in Sections 46 to 58 of the Act by reference, and the principal may modify the incorporated powers.

Drafting point – long form powers of attorney may be shorten by incorporating the statutory power by reference and adding certain limitations or additions to those incorporated powers.

HB 154, Section 45 grants the agent the necessary incidental authority to exercise the agent's authority generally granted over certain properties. Unless the power of attorney modifies this incidental authority, an agent with general authority over a certain asset has the additional authority to demand, collect, contract, communicate, litigate, hire agents, etc. with respect to that asset.

HB 154, Sections 46 to 58 define the actions an agent can undertake when granted general authority to act with respect to certain types of assets. These default powers are very broad and may encompass more authority than the principal realizes.

Section 46 Real Property.

Authority includes ability to sell, transfer, convey, pledge, mortgage, partition, subdivide, install and manage improvements, litigate, settle, reorganize entities that hold real estate, and change form of title.

Section 47 Tangible Personal Property.

Authority includes ability to sell, transfer, pledge, create an security interest in, manage, store, repair, change form of title.

Section 48 Stocks and Bonds.

Authority includes ability to buy, sell, and exchange stocks and bonds, establish, continue, modify or terminate accounts, pledge as security to borrow extend or renew debts, receive certificates, exercising voting rights.

Section 49 Commodities and Options.

Authority includes ability to buy, sell, exchange, assign, settle and exercise futures, puts and calls and establish, continue, modify or terminate accounts.

Section 50 Banks and Other Financial Institutions.

Authority includes ability to use, modify and terminate existing accounts, create new accounts, rent safe deposit box or enter existing safe deposit box, withdraw money by check, order or electronic funds transfer, receive account information, create debts, borrow funds, pledge assets, make, assign, draw and endorse checks and other negotiable instruments, use credit and debit cards, and electronic transaction authorization.

Section 51 Operation of Entities or Businesses.

Authority includes ability to operate, manage and maintain an entity, sell or enlarge an interest in the business, resolve disputes through litigation or alternative dispute resolutions, vote in person or by proxy, make capital contributions, enter a plan of reorganization or merger, sell or liquidate the business, establish value for buy-sell agreement, protect the principal from illegal or unnecessary taxation, assessments, fines or penalties.

Authority with respect to an entity solely owned by the principal includes authority to modify contracts entered into by the principal, change location of the operations, nature of the business, compensation of the employees, and the organization's form.

Section 52 Insurance and Annuities.

Authority includes ability to pay premiums, modify or terminate existing contracts, procure new contracts, create security interest for loans, surrender for cash value, exercise elections and investment authority.

Section 53 Estates, Trusts and Other Beneficial Interests.

Applies to a trust, probate estate, guardianship, conservatorship, escrow, custodianship or a fund from which the principal is, may become, or claims to be entitled to a share or payment.

Authority includes ability to accept, receive, sell, assign, pledge, demand payment, initiate or participate in litigation or settlement including the validity of the terms of a will, trust or deed or removal of a fiduciary.

exercise for the benefit of the principal a general power of appointment held by the principal.

transfer principal's property to a revocable trust created by the principal as the grantor.

reject, renounce, disclaim, release or consent to a reduction in or modification of a share in or payment from an estate, trust or other beneficial interest.

Section 54 Claims and Litigation.

Authority includes ability to initiate or be a party to litigation, compromise and settle litigation, waive or accept notice and service of process, make appearance, verify pleadings and statements of facts, execute waivers, consents, confession of judgement, notices and other instruments in connection with prosecution, settlement and defense of claims.

Does not specifically address arbitration agreements or contracts to waive right to litigation.

Section 55 Personal and Family Maintenance.

Authority includes ability to maintain customary standard of living for the principal, principal's spouse, children, other individuals legally entitled to be supported by the principal, and individuals the principal customarily supported.

Pay court ordered child support and maintenance.

Provide housing, normal domestic help, vacation and travel, food, clothing and education expenses, healthcare, transportation, maintain credit and debit account for convenience of the individuals or open new accounts, pay memberships or affiliations to religious institutions, clubs, other organizations.

Authority is not dependent on or limited by the general gifting authority under Section 59 even though some of these payments may be gifts.

Section 56 Benefits from Governmental Programs, Civil or Military Services.

Applies to any government benefits program including Social Security, Medicare and Medicaid.

Authority includes ability to enroll, apply, change benefits, prepare, file and maintain claims for a benefit or other assistance, receive financial proceeds and conserve, invest, disburse or use for a lawful purpose.

Section 57 Retirement Plans.

Authority includes ability to select timing of payments and withdraw benefits, make a rollover, trustee-to-trustee transfers, establish a new plan in the principal's name, make contributions, exercise investment powers, borrow, sell or purchase assets within the plan.

Section 58 Taxes.

Authority includes ability to prepare, sign and file tax returns, claims, extensions, refunds, petitions and other tax related documents, pay taxes, collect refunds, post bonds, receive confidential information, contest deficiencies, exercise elections, act for the principal in all tax matters before the IRS or other taxing authority.

HB 154, Section 59 Gifts.

General authority includes ability to make gifts of any property interest of the principal including the exercise of a presently exercisable general power of appointment in an amount per donee not to exceed the annual exclusion or double the annual exclusion for gift splitting with the principal's spouse; to consent to gift splitting with spouse.

Agent's exercise of gifting authority should be consistent with principal's objectives if known by the agent, or if unknown then as the agent determines is consistent taking into consideration principal's best interest based on:

Value and nature of principal's property;

Principal's foreseeable obligations and need for maintenance;

Minimization of taxes;

Eligibility for a benefit, program or assistance under statute or regulation; and

Principal's personal history of making gifts.

HB 154, Section 60 is a non-uniform provision which provides that "nothing in this chapter shall be construed to authorize an agent appointed pursuant to a power of attorney to act or make decisions on behalf of the principal which are not related to the principal's property or finances."

<u>Article 3 – Statutory Forms</u>

HB 154, Section 61 provides an optional statutory form with check the box and fill in the blank options. Signature lines provide for a notary but no witnesses; includes agent information sheet setting out the agents duties and obligations under the Act.

HB 154, Section 62 provides a form for the agents certification of the validity of the power of attorney and agent's authority.

Article 4 – Miscellaneous Provisions

HB 154, Sections 63, 64, and 65 repealed and reenacted KRS 457.240, .250, and .260. The new provisions should be effective as of July 14, 2020.

5. Revised Uniform Fiduciary Access to Digital Assets Act

Background.

In January 2012, the Uniform Law Commission authorized the formation of a drafting committee to write model legislation that would give fiduciaries the authority to manage, control and access digital assets. The final version of the legislation, known as the Uniform Fiduciary Access to Digital Assets Act ("UFADAA"), was approved in July 2014.

Although Delaware adopted the final draft version of UFADAA, the Act was immediately met with resistance by Internet-based businesses and privacy advocates when introduced in other states. After meetings with industry participants, the Revised Uniform Fiduciary Access to Digital Assets Act ("RUFADAA") was approved in July 2015.

Revisions made in RUFADAA clarify the application of privacy laws, better define the rights and duties of all parties, and give effect to an account holder's instructions for the disposition of digital assets. Specifically, the Act carves out an exception for digital assets and email systems of an employer used by an employee during the ordinary course of business, defers to an account holder's intent and privacy desires, encourages compliance by custodians, and protects fiduciaries, custodians and content providers.

To date, RUFADAA has been enacted in 45 states and territories, and introduced in 4 others.

> Enactments (45): Alabama, Alaska, Arizona, Arkansas, Colorado, Connecticut, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Oregon, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, U.S. Virgin Islands, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin and Wyoming.
>
> Introductions (4): District of Columbia, Massachusetts, Oklahoma, and Pennsylvania.

Kentucky is the most recent state to adopt RUFADAA which will take on July 15, 2020 as a new chapter of the Kentucky Revised Statutes, Chapter 395A. House Bill 156, signed by Gov. Beshear on March 27, 2020. Key provisions of the Act are as follows.

Section 1 – Definitions

What is a "digital asset"? Section 1, subsection (1) of the Act defines a "digital asset" as "an electronic record in which an individual has a right or interest. The term does not include an underlying asset or liability unless the asset or liability is itself an electronic record."

The Act does not specifically define "electronic communication" but instead incorporates the definition set forth in the Electronic Communication Privacy Act ("ECPA") (18 U.S.C. § 2510(12)). Under the ECPA, an electronic communication is "any transfer of signs, signals, writing, images, sounds, data, or intelligence of any nature transmitted in whole or in part by a wire, radio, electromagnetic, photoelectronic or photooptical system that affects interstate or foreign commerce." Specifically excluded from this definition are: (a) any wire or oral communication; (b) any communication made through a tone-only paging device; (c) any communication from a tracking device; and (d) electronic funds transfer information stored by a financial institution.

Notably, the Act differentiates between a "catalogue of electronic communications" and the "content of electronic communications." A "catalogue of electronic communications" is information which identifies each person the account holder communicated with, the date and time of the communication, and the electronic address of such person. The "content of electronic communications" is information concerning the substance or meaning of the communication which was sent or received by the account holder, is in electronic storage by a custodian, and is not readily accessible to the public.

Section 2 – User Assets Only

The Act makes clear that it applies to the digital assets of the account holder only. It does <u>not</u> apply to digital assets of an employer used by an employee in the ordinary course of the employer's business.

Sections 3 and 4 – User Direction for Disclosure of Digital Assets

Section 3 clarifies that account holders may consent to disclosure of their content either online or in a record, and that such consent will override any prohibition on disclosure contained in a custodian's Terms of Service Agreement ("TOSA"). Without online or written consent, custodians are not required to disclose user content.

In effect, Section 3 establishes a three-tier hierarchy for determining a user's intent:

1. On-line tool directions, if offered and modifiable.

2. Directions in will, trusts, powers of attorney or other records.

3. Terms of service agreement provisions (which will govern access for users who do not plan).

If a custodian provides an online mechanism to govern third party access and the tool allows the user to modify the direction at all times, the user's online direction supersedes contrary directions in an estate plan.

Section 4 makes clear that the Act does not override a custodian's TOSA (except to give effect to an account holder's express consent as provided in Section 3), nor does it change or impair a custodian's or user's rights under a TOSA to access and use digital assets. A fiduciary does not have greater rights than the user.

Section 6 – Disclosure of Content of Electronic Communications of Deceased User

If the user consented to disclosure or if a court directs disclosure, a custodian must disclose the contents of all electronic communications, if the personal representative provides:

1. A written request;

2. A death certificate;

3. A certified copy of the order of appointment, order dispensing with administration, or order granting access; and

4. A copy of the document evidencing the user's consent, if not made in an online tool.

Notwithstanding the above, the custodian may request the personal representative to provide the following additional information before disclosing the contents of the electronic communications:

1. A number, username, address, or other unique subscriber or account identifier to identify the user's account;

2. Evidence which links the account to the user;

3. A finding by the court that the user had the specific account with the custodian, that disclosure of the content of the user's electronic communications would not violate the Stored Communications Act (18 U.S.C. § 2701, *et seq*.,) or the Privacy of Customer Information provisions of the Communications Act of 1934 (47 U.S.C. § 222, as amended), that the user consented to disclosure of the content, and that such disclosure is reasonably necessary for administration of the estate.

Section 7 – Disclosure of Other Digital Assets of Deceased User

Unless the user prohibited disclosure or the court otherwise directs, a custodian must disclose a catalogue of electronic communications sent or received by the user and all other digital assets, excluding the content of electronic communications, of the user, if the personal representative provides a written request, a death certificate and a letter of appointment. The custodian may also request the information linking the account to the user, and either an affidavit of the necessity of the disclosure or a court order finding that the account was the user's and that disclosure is reasonably necessary.

Sections 8 and 9 Regarding Disclosure to an Agent

Unless prohibited by the principal or a court, an agent has access to the principal's digital assets, but only to the records (not the content) of the principal's electronic communications unless the principal expressly grants access to the content of the electronic communications. In addition to providing the custodian with identifying information about the principal's account, the agent must also provide the custodian with a copy of the principal's power of attorney as well as certification, under penalty of perjury, that the power of attorney is still in effect.

Sections 10, 11 and 12 Regarding Disclosure to a Trustee

Sections 11 and 12 provide that unless otherwise ordered by the court, directed by the user, or provided by the trust, a trustee must provide a custodian with information similar to that required by a personal representative or agent before the custodian is required to disclose the content of electronic communications, a catalogue of electronic communications, and other digital assets to the trustee, if the trustee is not the original user of the account. Under Section 10, if the trustee is the original user of the account, the custodian must disclose to the trustee any digital asset held in trust, including a catalogue of electronic communications of the trustee and the content of electronic communications.

Section 13 – Disclosure to a Conservator

The court may grant a conservator access to the digital assets of a protected person. Such authority only extends to the catalogue of electronic communications sent or received by the protected person and his or her digital assets. It does not extend to the content of the protected person's electronic communications. A conservator may manage the digital assets of the protected person and may request a custodian of such assets to suspend or terminate an account for good cause.

Section 14 – Fiduciary Duty and Authority

Section 14 reiterates that the same legal duties of care, loyalty, and confidentiality that apply to a fiduciary charged with managing tangible property also apply to the management of digital assets. This section also makes clear that a fiduciary's authority is subject to all applicable TOSAs (except as otherwise provided in Section 3), other applicable law, and may not be used to impersonate the user. Moreover, a fiduciary acting within the scope of the fiduciary's duties is an authorized user for purposes of applicable computer-fraud and unauthorized-computer-access laws.

Section 15 – Custodian Compliance and Immunity

A custodian must disclose all requested information or terminate an account within 60 days of receipt of the request for disclosure (or termination) with all required information. If the custodian fails to comply with such request, the fiduciary may request a court order directing compliance. Likewise, the custodian may require the fiduciary to obtain such an order before it discloses the requested information. A custodian may notify the account holder that a request for disclosure or to terminate an account was made and may deny a request if the custodian is aware of any lawful access to the account following receipt of the fiduciary's request. A custodian and its officers, employees, and agents are immune from liability when acting in good faith in compliance with the Act.

6. <u>Uniform Power of Appointment Act.</u>

<u>Overview.</u>

The Uniform Powers of Appointment Act (the Uniform Act) was promulgated in 2013 by the National Conference of Commissioners on Uniform State Laws (often referred to as NCCUSL), which in recent years has rebranded itself as the Uniform Law Commission ("ULC"). As of April 13, 2020, the Uniform Act has been enacted in Kentucky, Illinois, Utah, Nevada, Missouri, Virginia, New Mexico, Montana, North Carolina and Colorado. In Kentucky, the Uniform Act will be located in the newly formed KRS § 390. The ULC has summarized the Uniform Act as follows:

> A power of appointment is an estate planning tool that permits the owner of property to name a third party and give that person the power to direct the distribution of that property among some class of permissible beneficiaries. It is an effective and flexible technique used in a wide variety of situations, but there is very little statutory law governing the creation and use of powers of appointment. Instead, estate planning attorneys must rely on a patchwork of state court decisions. The drafters of the Uniform Powers of Appointment Act did not set out to change the law, but rather to codify the existing common law, relying heavily on the Restatement (Third) of Property: Wills and other Donative Transfers.

The Uniform Act is divided into six articles:

Article 1: General Provisions

Article 2: Creation, Revocation, and Amendment of Power of Appointment

Article 3: Exercise of Power of Appointment

Article 4: Disclaimer or Release; Contract to Appoint or Not to Appoint

Article 5: Rights of Powerholder's Creditors in Appointive Property

Article 6: Miscellaneous Provisions

Key Elements of the Uniform Act.

1. Nonfiduciary powers.

The Uniform Act is limited to nonfiduciary powers. See §102(13) and KRS § 390, Section 1(13). The ULC adopted in 2015 the Uniform Act on Trust Decanting. That act deals with fiduciary powers. In 2017 the ULC adopted the Uniform Directed Trust Act which provides that all actors in a trust, other than a beneficiary, have a fiduciary duty except for those with the power to remove and replace a trustee, and those whose power must not be limited by a fiduciary standard to accomplish a tax result (the classic example, perhaps the only example, being the power to substitute assets under section 675(40(C)).

Suppose that a trust instrument gives a person the power to appoint the trust property as the person determines but subject to a fiduciary standard. That power is properly viewed as akin to a trustee's power to distribute trust property, not as a power of appointment. Mixing the two concepts generates confusion. For example, suppose that Paula is given the power to appoint the trust property to or among any person or entity other than herself, her creditors, her estate, and the creditors of her estate, and the trust provides that Paula is a fiduciary. A question is: to whom does Paula have a fiduciary duty? Presumably, without more, her fiduciary duty runs to the beneficiaries of the trust, hence her ability to appoint is really an ability to distribute assets among the trust beneficiaries. Might a court construe her power as a power of appointment subject to a minimal "good faith" standard? There is no authority on the subject. Drafters ought to distinguish clearly between fiduciary powers of distribution and powers of appointment.

May a trustee also be given a power of appointment? That is, a person acting as trustee is also given the power, not acting as trustee, to exercise a power of appointment. Again, the answer is unclear. Whether a trustee is always acting as a fiduciary or can separate out when she is not a fiduciary is uncertain; but the better argument would seem to be no. How might a fiduciary go about acting in the best interests of the beneficiaries all day except from noon to one, for example?

The Restatement Third §§ 17.1 to 17.5 notes various other powers that are and are not powers of appointment:

> A power to revoke or amend a trust or a power to withdraw income or principal from a trust is a power of appointment, whether the power is reserved by the transferor or conferred on another.
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> A power to withdraw income or principal subject to an ascertainable standard is a postponed power, exercisable upon the satisfaction of the ascertainable standard.
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> A power to direct a trustee to distribute income or principal to another is a power of appointment. In this act, a fiduciary distributive power is not a power of appointment. Fiduciary distributive powers include a trustee's power to distribute principal to or for the benefit of an income beneficiary, or for some other individual, or to pay income or principal to a designated beneficiary, or to distribute income or principal among a defined group of beneficiaries. Unlike the exercise of a power of appointment, the exercise of a fiduciary distributive power is subject to fiduciary standards. Unlike a power of appointment, a fiduciary distributive power does not lapse upon the death of the fiduciary, but survives in a successor fiduciary. Nevertheless, a fiduciary distributive power, like a power of appointment, cannot be validly exercised in favor of or for the benefit of someone who is not a permissible appointee.
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> A power over the management of property, sometimes called an administrative power, is not a power of appointment. For example, a power of sale coupled with a power to invest the proceeds of the sale, as commonly held by a trustee of a trust, is not a power of appointment but is an administrative power. A power of sale merely authorizes the person to substitute money for the property sold but does not authorize the person to alter the beneficial interests in the substituted property.
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> A power to designate or replace a trustee or other fiduciary is not a power of appointment. A power to designate or replace a trustee or other fiduciary involves property management and is a power to designate only the nonbeneficial holder of property.
>
> A power to create or amend a beneficiary designation, for example with respect to the proceeds of a life insurance policy or of a pension plan, is not a power of appointment. An instrument creating a power of appointment must, among other things, transfer the appointive property. (citations omitted)

In In re Estate of Zucker, 2015 WL 5254061 (Pa. Superior Ct. 2015), decedent's wife, Syma, exercised a power of appointment in favor of two of three children. The third, Wendy, objected claiming:

> Wendy alleged that Syma's appointment was not a proper exercise of the power as it was done "in bad faith, based on hate and malice toward Wendy, contrary to [the Decedent's] intent to benefit his issue equally (absent a good faith reason to the contrary) and the duty imposed on Syma to act in good faith when exercising a testamentary power imposed by Pennsylvania law."

The court disagreed, declining even to impose a good faith standard. The opinion states:

> We have reviewed the language contained in Decedent's will and in the codicil to Syma's will in which she directed that the principal contained in the marital trust

> be divided into two trusts for the benefit of Scott and Karyn and their issue. We have also reviewed the case law provided by the parties and the orphans' court. We conclude that none of the cases, in which challenges to the exercise of the power of appointment were raised, direct that the appointments must be made in good faith. Rather, we state again that a donee's duty is to the donor and the donee must exercise that power within the donor's established conditions. Moreover, the donee has the right to select some of the potential appointees to the exclusion of others. See Estate of Kohler, 344 A.2d at 472. No duty of good faith has been established. Therefore, we conclude that the orphans' court's grant of Scott and Karyn's motion for judgment on the pleadings was proper. The orphans' court did not commit an error of law.

The court notes that Syma was not the trustee. Does that matter? Suppose she had been; her exercise of a testamentary power of appointment would seem to occur after service as trustee ended. May a trustee exercise an inter vivos power without following a fiduciary standard?

2. “Powerholder”.

The Uniform Act replaces the older, confusing term “donee” with the term “powerholder”. See §102(13) and KRS § 390, Section 1(14).

3. Terminology and categories of powers.

The black letter of the Uniform Act and the Comments to the Uniform Act explain the specialized terminology associated with powers of appointment and the categories into which powers of appointment are divided. See especially § 102.

An important distinction is between exclusionary and nonexclusionary powers. See KRS § 390, Section 1(5). The Comment to § 102 states:

> An exclusionary power is one in which the donor has authorized the powerholder to appoint to any one or more of the permissible appointees to the exclusion of the other permissible appointees. For example, a power to appoint “to such of my descendants as the powerholder may select” is exclusionary, because the powerholder may appoint to any one or more of the donor’s descendants to the exclusion of the other descendants. In contrast, a nonexclusionary power is one in which the powerholder cannot make an appointment that excludes any permissible appointee, or one or more designated permissible appointees, from a share of the appointive property. An example of a nonexclusionary power is a power “to appoint to all and every one of my children in such shares and proportions as the powerholder shall select.” Here, the powerholder is not under a duty to exercise the power; but, if the powerholder does exercise the power, the appointment must abide by the power’s nonexclusionary nature. See Sections 301 and 305. An instrument creating a power of appointment is construed as creating an exclusionary power unless the terms of the instrument manifest a contrary intent. See Section 203. The typical power of appointment is exclusionary. And in fact, only a power of appointment whose permissible appointees are “defined and limited” can be nonexclusionary.

Comment c to § 17.5 of the Restatement Third notes a trap for the unwary if the powerholder may appoint to a large class that is poorly defined:

> An attempt by the donor to require the [powerholder] to appoint at least $X to each permissible appointee of the power is ineffective, because the permissible appointees of the power are so numerous that it would be administratively impossible to carry out the donor's expressed intent. The donor's expressed restriction is disregarded, and the [powerholder] may exclude any one or more of the permissible appointees in exercising the power.

Another important distinction is between general and nongeneral powers. A power will be construed to be general unless the instrument specifically limits the power. In other words, "Fred may appoint the assets of the trust as Fred determines" is a general power because there are no words of limitation. A power to revoke, amend, or withdraw from trust is a general power of appointment if it is exercisable in favor of the powerholder, the powerholder's estate, or the creditors of either.

In 1986, when the current generation skipping tax was adopted, a planning idea that arose was the grant by a trustee, or someone else, of a general power to a beneficiary to avoid the tax and include the assets of the trust in the beneficiary's estate. Some commentators wondered if the ability of a trustee, or another person, to grant a power was tantamount to the potential powerholder having the power already. Section 2041(b)(1)(C) provides that a power that is exercisable with another person will nonetheless be a general power unless the person with whom the exercise is required is the creator of the power or is adverse (discussed below). The Comment to the Uniform Act supports the view that the ability to create a general power of appointment ought not to be viewed as the equivalent of the ability to exercise the power with another. The Comment to § 102 notes that if the grantor of a trust empowers a trustee or another person to change a power of appointment from a general power into a nongeneral power, or vice versa, the power is either general or nongeneral depending on the scope of the power at any particular time (emphasis added). That is, if a general power can be cut back or a nongeneral power expanded, for state law purposes the power is what it is at the time it is being looked at, not what it has been or could be. Although such a state-law determination may not be determinative for federal transfer tax purposes, it does support an interpretation favorable to taxpayers.

A power that can only be exercised with the consent of an adverse party is nongeneral. See § 205 and KRS § 390, Section 8. An adverse party is defined by § 205(a) as a person with a substantial beneficial interest in property which would be affected adversely by a powerholder's exercise or nonexercise of a power of appointment in favor of the powerholder, the powerholder's estate, a creditor of the powerholder, or a creditor of the powerholder's estate. The adversity must be in the trust itself, not inferred from the general circumstances (see the Comment to § 205). What is substantial depends on the circumstances. The Comment to § 205 gives these examples:

> *Example 1.* D transferred property in trust, directing the trustee "to pay the income to D's son S for life, remainder in corpus to such person or persons as S, with the joinder of X, shall appoint; in default of appointment, remainder to X." S's power is not a general power because X meets the definition of an adverse party.

Example 2. Same facts as Example 1, except that S's power is exercisable with the joinder of Y rather than with the joinder of X. Y has no property interest that could be adversely affected by the exercise of the power. Because Y is not an adverse party, S's power is general.

Whether the party whose consent or joinder is required is adverse or not is determined at the time in question. Consider the following example.

Example 3. Same facts as Example 2, except that, one month after D's creation of the trust, X transfers the remainder interest to Y. Before the transfer, Y is not an adverse party and S's power is general. After the transfer, Y is an adverse party and S's power is nongeneral.

4. Choice of law.

The creation, revocation, or amendment of the power is governed by the law of the donor's domicile; the exercise, release, or disclaimer of the power (or the revocation of the exercise) is governed by the law of the powerholder's domicile at the time of the exercise, release, disclaimer or revocation. See §104 and KRS § 390, Section 2. The instrument creating the power may alter this default choice of law rule.

Traditionally, the law of the domicile of the person creating the power governed both the creation and the exercise. The Uniform Act changed that older rule to adopt the modern Restatement rule that the acts of the powerholder ought to be governed by the law of the powerholder's domicile because, after all, that is the law the powerholder, and the powerholder's lawyer, is most likely to know. (For commentary on this issue, see the Restatement Third § 19.1, Comment e; Restatement Second of Conflict of Laws § 275, Comment c; Estate of McMullin, 417 A.2d 152 (Pa. 1980); White v. United States, 680 F.2d 1156 (7th Cir. 1982).) If drafting for a situation where definitions or the law may differ, specifically defining key terms to ensure clarity is advisable. For example, the effect of adoption on the definition of "children" or "descendants" may differ from state to state.

5. An important exception to the presumption of unlimited authority.

The Uniform Act articulates, as a default rule of construction, that a power falls into the category giving the powerholder the maximum discretionary authority except to the extent the terms of the instrument creating the power restrict that authority. Thus, powers are presumed to be general, presently exercisable, and exclusionary unless the donor specifies otherwise. See §203 and KRS § 390, Section 6.

However, to correct a recurring drafting mistake, the Uniform Act presumes that a power is nongeneral if (1) the power is exercisable only at the powerholder's death and (2) the permissible appointees are a defined and limited class excluding the powerholder's estate, the powerholder's creditors, and the creditors of the powerholder's estate. See § 204, KRS § 390, Section 7. In other words, if a parent gives a child the testamentary power to appoint among the parent's descendants, the child is presumed not to be able to appoint to the child, the child's estate, or the creditors of either. This has been the subject of litigation in state courts and private letter rulings, reaching results consistent with the Uniform Act. See, e.g., Hillman v. Hillman, 744 N.E.2d 1078 (Mass. 2001) (holding that, where the powerholder was the donor's son, a testamentary power to appoint to the donor's "issue" was a nongeneral power); PLRs 9623043, 199938024, 201006005, 201229005, 201446002.

6. Best practices when drafting the exercise of a power of appointment.

How ought powers of appointment be exercised? Unsurprisingly, the Uniform Act urges clarity and specificity rather than general exercises of "any" power of appointment that powerholder has. However, § 301 and KRS § 390, Section 10, contains additional law beyond this general statement. The section provides:

> **SECTION 10. REQUISITES FOR EXERCISE OF POWER OF APPOINTMENT. A power of appointment is exercised only:**
>
> (1) if the instrument exercising the power is valid under applicable law;
>
> (2) if the terms of the instrument exercising the power:
>
> (A) manifest the powerholder's intent to exercise the power; and
>
> (B) subject to Section 14 of this Act, satisfy the requirements of exercise, if any, imposed by the donor; and
>
> (3) to the extent the appointment is a permissible exercise of the power.

The first item to notice is that a power of appointment may be exercised by either a will or a revocable trust. The Comment confirms this:

> Paragraph (1) states the fundamental principle that an instrument can only exercise a power of appointment if the instrument, under applicable law, is valid (or partially valid, see the next paragraph). Thus, for example, a *will* exercising a power of appointment must be valid under the law—including choice of law (see Section 103)—applicable to wills. An *inter vivos trust* exercising a power of appointment must be valid under the law—including choice of law (see Section 103)—applicable to inter vivos trusts.

Further, Paragraph (2) requires the terms of the instrument exercising the power of appointment to manifest the powerholder's intent to exercise the power. Whether a powerholder has manifested an intent to exercise a power is a question of construction, and intent may be manifested even though the powerholder does not refer to the power. The terms of the instrument exercising the power must satisfy the requirements of exercise, if any, imposed by the donor, although as discussed below the Uniform Act also contains a substantial compliance doctrine.

Language expressing an intent to exercise a power is clearest if it makes a specific reference to the creating instrument and exercises the power in unequivocal terms and with careful attention to the requirements of exercise, if any, imposed by the donor. Thus, the recommended method for exercising a power of appointment is by a specific-exercise clause, using language such as the following: "I exercise the power of appointment conferred upon me by [my father's will] as follows: I appoint [fill in details of appointment]."

Not recommended is a blanket-exercise clause, which purports to exercise "any" power of appointment the powerholder may have, using language such as the following: "I exercise any power of appointment I may have as follows: I appoint [fill in details of appointment]." Although a blanket-exercise clause does manifest an intent to exercise any power of appointment the powerholder may have, such a clause raises the often-litigated question of whether it satisfies the requirement of specific reference imposed by the donor in the instrument creating the power. § 102(3) defines a blanket-exercise clause as a clause in an instrument which exercises a power of appointment and is not a specific-exercise clause. It includes a clause that: (A) expressly uses the words "any power" in exercising any power of appointment the powerholder has; (B) expressly uses the words "any property" in appointing any property over which the powerholder has a power of appointment; or (C) disposes of all property subject to disposition by the powerholder. § 302 of the Uniform Act and Section 11 of KRS § 390 provides that a residuary clause is not a blanket-exercise clause and will not be deemed to manifest the intent to exercise a power of appointment except in a very few instances:

SECTION 11. INTENT TO EXERCISE: DETERMINING INTENT FROM RESIDUARY CLAUSE.

(a) In this section:

(1) "Residuary clause" does not include a residuary clause containing a blanket-exercise clause or a specific-exercise clause.

(2) "Will" includes a codicil and a testamentary instrument that revises another will.

(b) A residuary clause in a powerholder's will, or a comparable clause in the powerholder's revocable trust, manifests the powerholder's intent to exercise a power of appointment only if:

(1) the terms of the instrument containing the residuary clause do not manifest a contrary intent;

(2) the power is a general power exercisable in favor of the powerholder's estate;

(3) there is no gift-in-default clause or the clause is ineffective; and

(4) the powerholder did not release the power.

Also not recommended are blending clauses. A blending clause purports to blend the appointive property with the powerholder's own property in a common disposition. The exercise portion of a blending clause can take the form of a specific exercise or, more commonly, a blanket exercise. For example, a clause providing "All the residue of my estate, including the property over which I have a power of appointment under my mother's will, I devise as follows" is a blending clause with a specific exercise. A clause providing "All the residue of my estate, including any property over which I may have a power of appointment, I devise as follows" is a blending clause with a blanket exercise. The Uniform Act aims to eliminate any significance attached to the use of a blending clause. A blending clause has traditionally been regarded as significant in the application of the doctrines of "selective allocation" and “capture.” The Uniform Act eliminates the significance of such a clause under those doctrines. See §§ 308 (selective allocation) and 309 (capture), KRS § 390 Section 17 and 18, respectively. The use of a blending clause is more likely to be the product of the forms used by the powerholder’s lawyer than a deliberate decision by the powerholder to facilitate the application of the doctrines of selective allocation or capture.

Suppose a powerholder does not want to exercise a power. In general, the powerholder ought either to release the power, an action provided for in Uniform Act § 402 and KRS § 390, Section 25, unless the terms of the instrument creating the power prevent the release, or to include a non-exercise clause in the powerholder’s will or revocable trust. A nonexercise clause can take the form of a specific-nonexercise clause (for example, “I do not exercise the power of appointment conferred on me by my father’s trust”) or the form of a blanket-nonexercise clause (for example, “I do not exercise any power of appointment I may have”). The property subject to the power could pass differently depending on which choice was made. That is, the takers in default of exercise could be different if the powerholder released the power during lifetime or died with the power but did not exercise it. In effect, the way in which the power is not exercised becomes a power of appointment. Note that this inaction could have tax consequences depending on the identity of the takers in default.

7. After-Acquired Powers.

Section 303 of the Uniform Act sets forth the general rule that a blanket-exercise clause will exercise a power granted after the instrument exercising the power was executed. See KRS § 390, Section 12. Such powers are referred to as “after-acquired” powers – powers acquired before a powerholder’s death. A power of appointment cannot be given to a powerholder who is deceased when the power is created. If the powerholder dies before the effective date of an instrument purporting to confer a power of appointment, the power is not created, and an attempted exercise of the power is ineffective. But note a difference between powers created in wills and in revocable trusts. The effective date of a power of appointment created in a Will is the testator’s death, not when the testator executes the Will. The effective date of a power of appointment created in an inter vivos trust is the date the trust is established, even if the trust is revocable. See Restatement Third § 19.11, Comments b and c. (Of course, a power of appointment can be conferred on an unborn or unascertained powerholder, subject to any applicable rule against perpetuities. This is a postponed power that arises on the powerholder’s birth or ascertainment.)

Nothing in the law prevents a powerholder from exercising a power in an instrument executed before acquiring the power. The only question is one of construction: whether the powerholder intended by the earlier instrument to exercise the after-acquired power. If the instrument of exercise specifically identifies the power to be exercised, then the question of construction is readily answered: the specific-exercise clause expresses an intent to exercise the power, whether the power is after-acquired or not. However, if the instrument of exercise uses only a blanket-exercise clause, the question of whether the powerholder intended to exercise an after-acquired power is often harder to answer. The presumptions in § 303 provide default rules of construction on the powerholder’s likely intent. Unless the terms of the instrument indicate that the powerholder had a different intent, a blanket-exercise clause extends to a power of appointment acquired after the powerholder executed the instrument containing the blanket-exercise clause. General references to then-present circumstances, such as “all the powers I have” or similar expressions, are not a sufficient indication of an intent to exclude an after-acquired power. In contrast, more precise language, such as “all powers I have at the date of execution of this will,” does indicate an intent to exclude an after-acquired power.

Of course, even if the terms of the instrument manifest an intent to exercise an after-acquired power, the intent may be ineffective, because, for example, the terms of the instrument creating the power manifest an intent to preclude such an exercise. In the absence of an indication to the contrary, however, it is inferred that the time of the execution of the powerholder’s exercising instrument is immaterial to the person who created the power. Even a declaration that the property shall pass to such persons as the powerholder “shall” or “may” appoint does not suffice to indicate an intent to exclude exercise by an instrument previously executed, because these words may be construed to refer to the time when the exercising document becomes effective.

There is one exception to the general rule. Paragraph (2) of § 303 provides that if the powerholder is also the donor, a blanket-exercise clause in a preexisting instrument is reputably presumed not to manifest an intent to exercise a power later reserved in another donative transfer, unless the donor/powerholder did not provide for a taker in default of appointment or the gift-in-default clause is ineffective. For example, if a grantor created an incomplete-gift trust for income purposes, a blanket-exercise clause will not exercise the nongeneral powers of appointment so retained.

8. Substantial compliance with donor-imposed formal requirements.

A tension in the law that recurs regularly is between the need for bright-line rules and the need to carry out the intent of donors and drafters. The imposition of specific requirements—wills must have a specific number of witnesses or powers of appointment must be exercised exactly as specified in the instrument of creation—create bright-line rules but often at the expense of carrying out intent. With respect to the exercise of powers of appointment, the Uniform Act adopts a substantial compliance doctrine. Section § 304, and KRS § 390, Section 13, provides that a powerholder’s substantial compliance with a formal requirement of appointment imposed by the donor, including a requirement that the instrument exercising the power of appointment make reference or specific reference to the power, is sufficient if: (1) the powerholder knows of and intends to exercise the power; and (2) the powerholder’s manner of attempted exercise of the power does not impair a material purpose of the donor in imposing the requirement.

Substantial compliance can only be used with respect to formal requirements imposed by the creator of the power. If the power was created by will, the formal requirements for creation of a will in the applicable state must be followed. Further, substantial compliance does not apply to substantive requirements imposed for the exercise of the power, for example that a power may be exercised only after the powerholder reaches a certain age.

A straightforward example of where substantial compliance would suffice arises where the power requires exercise by will. Under the Uniform Act (see the Comment to § 304), a donor’s requirement that the power of appointment be exercised "by will" may be satisfied by the powerholder's exercise in a nontestamentary instrument that is functionally similar to a will, such as the powerholder's revocable trust that remains revocable until the powerholder's death. See also Restatement Third § 19.9, Comment b ("Because a revocable trust operates in substance as a will, a power of appointment exercisable "by will" can be exercised in a revocable-trust document, as long as the revocable trust remained revocable at the [powerholder]'s death.").

Often powers require that a powerholder must make specific reference to a power in order for it to be exercised. It is generally believed that those requirements are a holdover from 70 years ago. General powers of appointment created prior to October 21, 1942 did not cause inclusion of property in the gross estate unless exercised; thus, specific-reference clauses are thought to be a pre-1942 invention designed to prevent an inadvertent exercise of a general power. But, of course, the federal estate tax law has changed and for a general power created after October 21, 1942, estate tax consequences do not depend on whether the power is exercised. Because the original purpose of the specific-reference requirement was to prevent an inadvertent exercise of the power, it seems reasonable to presume that that this is still the purpose in most instances. Consequently, a specific-reference requirement still overrides any applicable state law that presumes that an ordinary residuary clause was intended to exercise a general power. In other words, an ordinary residuary clause may manifest the powerholder's intent to exercise but does not satisfy the requirements of exercise if the donor imposed a specific-reference requirement.

Ought a blanket-exercise clause satisfy a specific-reference requirement? If it could be shown that the powerholder had knowledge of and intended to exercise the power, the blanket-exercise clause would be sufficient to exercise the power, unless it could be shown that the donor's intent was not merely to prevent an inadvertent exercise of the power but instead that the donor had a material purpose in insisting on the specific-reference requirement. In such a case, the possibility of applying Uniform Probate Code § 2-805 or Restatement Third § 12.1 to reform the powerholder's attempted appointment to insert the required specific reference should be explored.

If a particular means of exercise is intended for some specific purpose, then it should be specified in the creation of the power as a material purpose. For example, "This power of appointment may be exercised only by specific reference to this paragraph and this requirement is material to the power."

9. Modern version of "capture doctrine".

Following the Restatement Third, the Uniform Act adopts a modern version of the "capture doctrine" concerning the disposition of property ineffectively appointed under a general power. Essentially, the gift-in-default clause controls; but, to the extent the gift-in-default clause is nonexistent or ineffective, the property passes to the powerholder or the powerholder's estate, if permissible, otherwise to the donor or the donor's transferee or successor in interest. See §309 of the Uniform Act and the Comments.

10. Authority to disclaim or release power.

The Uniform Act provides rules on the disclaimer (§401) or release (§§402-404) of a power. See KRS § 390, Section 24 and 25, respectively. PLRs 9526018 and 9526019 illustrate the disclaimer of powers of appointment. Suppose that Child 1 could receive income and principal for a "specified standard" from a generation-skipping trust and also had lifetime and testamentary nongeneral powers of appointment. The child disclaimed the nongeneral powers. The child also disclaimed the right under the trust to change trustees and to serve as trustee. The IRS ruled as follows:

> Section 25.2518-3(a)(1)(iii) provides that a power of appointment with respect to property is treated as a separate interest in the property and the power of appointment with respect to all or an undivided portion of the property may be disclaimed independently from any other interests separately created by the transferor in the property, if the requirements of §2518(b) are met. Further, a disclaimer of a power of appointment with respect to property is a qualified disclaimer only if any right to direct the beneficiary enjoyment of the property that is retained by the disclaimant is limited by an ascertainable standard.
>
> * * *
>
> In this case, Child 1 intends to disclaim certain rights provided in the generation skipping trust established for him at Decedent's death. Specifically, Child 1 intends to disclaim his inter vivos and testamentary power to appoint trust property, the power to change the trustee, and the right to serve as trustee either presently or in the future. Child 1 has represented that he has not accepted any of the benefits of Trust. We conclude that, if Child 1's proposed disclaimer is timely and otherwise satisfies the requirements provided in §2518, and is valid under state law, the disclaimers will be qualified disclaimers under §2518. See, §25.2518-3(a)(1)(iii).

If the exercise of a power of appointment requires the action of two or more individuals, each powerholder has a power of appointment. If one but not the other joint powerholder releases the power, the power survives in the hands of the nonreleasing powerholder, unless the continuation of the power is inconsistent with the donor's purpose in creating the joint power. Absent a contrary provision in the power, it may be released in part as well as entirely. A partial release is a release that narrows the freedom of choice otherwise available to the powerholder but does not eliminate the power. A partial release may relate either to the manner of exercising the power or to the persons in whose favor the power may be exercised.

11. Permissible and impermissible appointees, and fraud on exercise.

One of the most complex areas when dealing with powers of appointments is ascertaining who are permissible and impermissible appointees. Three rules are set forth in § 305 and KRS § 390, Section 14. It is important to not Kentucky has made a notable amendment from the Uniform Act in Section 14, this change is discussed below.

First, a powerholder of a general power that permits appointment to the powerholder or the powerholder's estate may make any appointment, including an appointment in trust or creating a new power of appointment, that the powerholder could make in disposing of the powerholder's own property. The Comment to § 305 explains the truly broad nature of the general power stating:

> When a donor creates a general power under which an appointment can be made outright to the powerholder or the powerholder's estate, the necessary implication is that the powerholder may accomplish by an appointment to others whatever the powerholder could accomplish by first appointing to himself and then disposing of the property, including a disposition in trust or in the creation of a further power of appointment. A general power to appoint only to the powerholder (even though it says "and to no one else") does not prevent the powerholder from exercising the power in favor of others. There is no reason to require the powerholder to transform the appointive assets into owned property and then, in a second step, to dispose of the owned property. Likewise, a general power to appoint only to the powerholder's estate (even though it says "and to no one else") does not prevent an exercise of the power by will in favor of others. There is no reason to require the powerholder to transform the appointive assets into estate property and then, in a second step, to dispose of the estate property by will. Similarly, a general power to appoint to the powerholder may purport to allow only one exercise of the power, but such a restriction is ineffective and does not prevent multiple partial exercises of the power. To take another example, a general power to appoint to the powerholder or to the powerholder's estate may purport to restrict appointment to outright interests not in trust, but such a restriction is ineffective and does not prevent an appointment in trust. An additional example will drive home the point. A general power to appoint to the powerholder or to the powerholder's estate may purport to forbid the powerholder from imposing conditions on the enjoyment of the property by the appointee. Such a restriction is ineffective and does not prevent an appointment subject to such conditions.

Second, a powerholder of a general power that permits appointment only to the creditors of the powerholder or of the powerholder's estate may appoint only to those creditors. Neither the Comment to the Uniform Act nor the Restatement Third provides further guidance on the meaning of this provision. Suppose Fred has the power to appoint the property of a trust worth $1,000,000 to his children, Tom, Dick, and Harry, and to his creditors. At a given moment, Fred owes Myrtle and Slim each $100. When listing the potential appointees of Fred's power do we say "Tom, Dick, Harry, Myrtle and Slim?" Or are Myrtle and Slim different? At the moment Fred exercises the power to appoint property to Myrtle she is a creditor, yet as soon as she receives $100 she ceases to be a creditor.

The issue also arises with a power to appoint to the creditors of the estate. Suppose that Fred may appoint $1,000,000 among his children, Tom, Dick, and Harry, and the creditors of his estate. At his death, Fred owes $100 to each of Myrtle and Slim. Suppose that Fred has exercised his power to appoint the assets among all permissible appointees to the maximum amount each may receive and equally among those who may receive any amount. Do Myrtle and Slim receive $100 each or $200,000 each (1/5th of $1,000,000). Although it is true that once Myrtle and Slim each receive $100 they cease to be creditors, it is equally true that at the moment of exercise—Fred's death—they were creditors. Put another way, ought the law of powers of appointment imply a limitation "to the extent" the appointee is a creditor?

The question is not entirely academic. The power to appoint to the creditors of the estate is commonly considered the narrowest general power that can be given. If appointment to a creditor is not limited to the amount the creditor is owed, then the power is not as narrow.

Third, under Kentucky law specifically, with respect to nongeneral powers, unless the terms of the instrument creating a power of appointment manifest a contrary intent, the powerholder may:

(1) make an appointment in any form, including an appointment in trust, in favor of a permissible appointee;

(2) create a general power in a permissible appointee; or

(3) create a nongeneral power in any permissible appointee to appoint to whomever the powerholder chooses, including non-permissible appointees of the original nongeneral power.

Section 14(3)(c), the last option described above, changes the default rules and allows broader appointment than under the Uniform Act. Instead of needing the instrument to allow a nongeneral power in a permissible appointee to be broader than the original nongeneral power, the Kentucky statute makes this the default provision. This notable difference in the statutes is important to highlight because it may require more specific drafting to effectuate original grantor intent.

Any exercise of a power in favor of an impermissible appointee is ineffective. § 307(a) and KRS § 390, Section 15(1). Further, an exercise in favor of a permissible appointee is ineffective to the extent the appointment is a fraud on the power. The concept of "fraud on the power" is explained in the Comment to § 307 as follows:

> Among the most common devices employed to commit a fraud on the power are: an appointment conditioned on the appointee conferring a benefit on an impermissible appointee; an appointment subject to a charge in favor of an impermissible appointee; an appointment upon a trust for the benefit of an impermissible appointee; an appointment in consideration of a benefit to an impermissible appointee; and an appointment primarily for the benefit of the permissible appointee's creditor if the creditor is an impermissible appointee. Each of these appointments is impermissible and ineffective.

Sections 19.15 and 19.16 of the Restatement Third of Property provide additional discussion and illustrations.

Section 19.16 discusses situations where appointments are made to permissible appointees for the benefit of impermissible appointees. That section states that:

> An appointment to a permissible appointee is ineffective to the extent that it was (i) conditioned on the appointee conferring a benefit on an impermissible appointee, (ii) subject to a charge in favor of an impermissible appointee, (iii) upon a trust for the benefit of an impermissible appointee, (iv) in consideration of a benefit conferred upon or promised to an impermissible appointee, (v) primarily for the benefit of the appointee's creditor, if that creditor is an impermissible appointee, or (vi) motivated in any other way to be for the benefit of an impermissible appointee.

12. Contract to exercise a power.

A power of appointment is nontransferable. The powerholder may not transfer the power to another person. If the powerholder dies without exercising or releasing the power, the power lapses. If the powerholder partially releases the power and dies without exercising the remaining part, the unexercised part of the power lapses. The power does not pass through the powerholder's estate to the powerholder's successors in interest. In short, a power of appointment is not a property interest.

However, a powerholder may contract to exercise or not exercise a power of appointment in certain circumstances. The easiest case is that of a presently exercisable power of appointment because of its ownership-equivalent nature. Section 405 of the Uniform Act and Section 28 of KRS § 390 sets forth the rule that the powerholder may contract not to exercise the power, or to exercise it so long as the exercise does not confer a benefit upon an impermissible donee. Although a general power presently exercisable in favor of the powerholder or the powerholder's estate has no impermissible appointees, a presently exercisable nongeneral power, or a general power presently exercisable only in favor of one or more of the creditors of the powerholder or the powerholder's estate, does have impermissible appointees.

If a power is not presently exercisable, no enforceable contractual obligation with regard to the exercise or nonexercise of the power may arise except in the limited circumstance where the powerholder also created the power and reserved the power in a revocable trust. § 406 and KRS § 390, Section 29. The theory behind this rule is that because the powerholder does not have the power to make a present appointment, the powerholder cannot agree to an appointment now because the creator of the power has manifested an intent that the selection of the appointees and the determination of the interests they are to receive are to be made in the light of the circumstances that exist on the date that the power becomes exercisable. Further, if something of value moves from the promisee to the powerholder in exchange for the powerholder's promise to appoint, and the powerholder or the powerholder's estate is not a permissible appointee of the power (the power is not a general power), the contract would be invalid on the independent ground that it confers a benefit on an impermissible appointee. This rule includes a promise not to revoke an existing will (or revocable trust) that exercises a power. Quite obviously, where the powerholder could revoke a revocable trust and acquire fee ownership of the property, the general rule does not apply.

§ 407 of the Uniform Act and Section 30 of KRS § 390 provide that a breach of contract may be remedied in appropriate circumstances by specific performance or by damages, but is limited to those payable from the appointive property. The powerholder's own assets are not at risk under the Uniform Act.

13. Creditors' rights.

The Uniform Act provides rules on the rights of the powerholder's creditors in the appointive property. These rules vary depending on whether the power is a general power created by the powerholder (§501 & KRS § 390, Section 31), a general power created by someone other than the powerholder (§502 & KRS § 390, Section 32), or a nongeneral power (§50 & KRS § 390, Section 33).

There is also a provision (§503) treating a power of withdrawal from a trust as the equivalent of a presently exercisable general power for this purpose; but upon the lapse, release, or waiver of the power of withdrawal, the Uniform Act follows the Uniform Trust Code in creating an exception for property subject to a Crummey or other five and five power. This section is not included in the Kentucky Act, however one may argue a right to withdrawal still qualifies as a power of appointment under KRS § 390, Section 1(13).

(1) A general power created by the powerholder will be ineffective to shelter assets from creditors. See § 501 and KRS § 390, Section 31. First, Section 31(2) states the well-settled rule that the creator of a power of appointment cannot use a fraudulent transfer to avoid creditors, the fraudulent transfer rules can be found in KRS 378A. If a donor fraudulently transfers appointive property, retaining a power of appointment, the donor/powerholder's creditors and the creditors of the donor/powerholder's estate may reach the appointive property as provided in the law of fraudulent transfers. On the other hand, as KRS § 390, Section 31(3) states, if there is no fraudulent transfer, and the donor/powerholder has made an irrevocable appointment to a third party of the appointive property, the appointed property is beyond the reach of the donor/powerholder's creditors or the creditors of the donor/powerholder's estate. In other words, an irrevocable and nonfraudulent exercise of the general power by the donor/powerholder in favor of someone other than the powerholder or the powerholder's estate eliminates the ability of the powerholder's creditors or the creditors of the powerholder's estate to reach those assets. Finally, § 501(d) and Section 31(4) deal with the in-between situation where the donor has retained a general power of appointment but has made neither a fraudulent transfer nor an irrevocable appointment. In such a case, the following rules apply. If the donor retains a presently exercisable general power of appointment, the appointive property is subject to a claim of—and is reachable by—a creditor of the powerholder to the same extent as if the powerholder owned the appointive property. If the donor retains a general power of appointment exercisable at death, the appointive property is subject to a claim of—and is reachable by—a creditor of the donor/powerholder's estate (defined with reference to other law, but including costs of administration, expenses of the funeral and disposal of remains, and statutory allowances to the surviving spouse and children) to the extent the estate is insufficient, subject to the decedent's right to direct the source from which liabilities are paid. This same rule applies under the Uniform Trust Code, § 505(a), where a grantor may revoke a revocable trust. The application of these rules is not affected by the presence of a spendthrift provision or by whether the claim arose before or after the creation of the power of appointment.

These rules apply even if someone else nominally created the power, to the extent the powerholder contributed value to the transfer. The Comment to § 501 sets forth these examples:

> *Example 1*. D purchases Blackacre from A. Pursuant to D's request, A transfers Blackacre "to D for life, then to such person as D may by will appoint." The rule of subsection (d) applies to D's general testamentary power, though in form A created the power.
>
> *Example 2*. A by will transfers Blackacre "to D for life, then to such persons as D may by will appoint." Blackacre is subject to mortgage indebtedness in favor of X in the amount of $10,000. The value of Blackacre is $20,000. D pays the

> mortgage indebtedness. The rule of subsection (d) applies to half of the value of Blackacre, though in form A's will creates the general power in D.
>
> *Example 3*. D, an heir of A, contests A's will on the ground of undue influence on A by the principal beneficiary under A's will. The contest is settled by transferring part of A's estate to Trustee in trust. Under the trust, Trustee is directed "to pay the net income to D for life and, on D's death, the principal to such persons as D shall by will appoint." The rule of subsection (d) applies to the transfer in trust, though in form D did not create the general power.

These rules were applied in Phillips v. Moore, 690 S.E.3d 620 (Ga. 2010). In 1996, Delmus Phillips created a trust to hold real estate for his benefit and the benefit of his family. Under the trust instrument, Phillips was entitled to receive the net income of the trust during his life. Phillips also had a testamentary power of appointment that allowed him to appoint the trust property to anyone of his choosing, including his own estate or creditors. The trust named specific beneficiaries in the event that Phillips failed to exercise the power, and also contained a spendthrift provision that protected the income and principal of the trust from claims of creditors. Phillips filed for bankruptcy in 2007, and the bankruptcy trustee moved for judgment as to whether the spendthrift provision was enforceable. The court granted the trustee's motion and held that the corpus was property of the bankruptcy estate. On appeal, the court noted the lack of controlling Georgia law and certified to the Georgia Supreme Court "whether a settlor of a trust is a sole beneficiary, such that creditors may reach the corpus of the trust, when the trust instrument gives the settlor no right to the corpus during his lifetime but provides him with a general power to appoint the trust corpus as he sees fit in his will and names specific beneficiaries to receive the corpus of the trust in the event that the settlor does not exercise his power of appointment?" The court answered in the affirmative, holding that an income right plus a general testamentary power of appointment allows creditors to reach even the trust corpus during the settlor's life despite the presence of a spendthrift provision.

(2) A general power created by someone other than the powerholder is dealt with by KRS § 390, Section 32 and is vastly different than the Uniform Act. Under the Kentucky adopted statute, appointive property subject to a general power of appointment created by a person other than the powerholder is not subject to a claim of a creditor of the powerholder or the powerholder's estate.

The Uniform Act follows the Restatement Third § 22.3, but Kentucky law follows historical common law. The common law is highlighted in this Comment to the Uniform Act:

> *c. Historical note.* The common-law rule was that the [powerholder's] creditors could not reach appointive assets covered by an unexercised general power of appointment if the power had been created by a person other than the [powerholder]. The thought was that until the [powerholder] exercised the power, the [powerholder] had not accepted sufficient control over the appointive assets to give the [powerholder] the equivalent of ownership of them.

The majority view at common law is that the powerholder of a power, conferred on the powerholder by another, is treated as the beneficial owner of the appointive property for purposes of creditors' rights only if (1) the power is general and (2) the powerholder exercises the power. Under the Kentucky law, no distinction is made between a testamentary and a presently exercisable power and creditors of a powerholder of a general power cannot reach the appointive assets even if the power was effectively exercised.

In a minority of jurisdictions, including Kentucky, the powerholder of a general power, conferred on him or her by another, is *not* treated as the owner of the appointive property even if the power is exercised. See, e.g., St. Matthews Bank v. DeCharette, 83 S.W.2d 471 (Ky. 1935). Of course, if the powerholder exercises the power in favor of himself or herself or his or her estate, the appointed property becomes owned in the technical sense, and creditors even in states adhering to the minority view would be able to subject the assets to the payment of their claims to the same extent as other property owned beneficially by the powerholder. A minority of states has enacted legislation that affects the rights of the powerholder's creditors. The legislation is not uniform. Some of the legislation expands the rights of the powerholder's creditors and some contracts them. The following is a sampling of the legislation.

> *Michigan* legislation expands the rights of the creditors of the powerholder of an *unexercised* general power. During the powerholder's lifetime, the powerholder's creditors can subject the appointive property to the payment of their claims if the power is presently exercisable. (If the powerholder has actually made an inter vivos exercise of the power, the rules explained above with respect to inter vivos exercises presumably would be applied.) At the powerholder's death, the powerholder's creditors can subject the appointive property to the payment of their claims. In both instances, however, the appointive property is available only to the extent that the powerholder 's owned property is insufficient to meet the debts. See Mich. Comp. Laws §556.123.
>
> *New York* legislation expands the rights of the powerholder's creditors in some particulars but restricts them in others. The legislation adopts the same rules as the Michigan legislation, but limits their application to general powers presently exercisable. As to general testamentary powers, the powerholder's estate creditors can subject the appointive property to the payment of their claims only if the powerholder, as donor, reserved the power in himself or herself; as to general testamentary powers conferred on the powerholder by another, the powerholder's estate creditors cannot reach the appointive property even when the powerholder's will *exercises* the power. See N.Y. Est. Powers & Trusts Law §§10-7.1 et seq.

Whether a state follows the common law rule or the new Restatement rule with respect to the rights creditors have to property subject to an unexercised general power of appointment will be relevant when considering the wisdom of giving a trust beneficiary a general power for tax purposes, typically to attract new basis. If the beneficiary has a reasonable possibility of having substantial creditors at death, the risk that the trust property, which likely had no previous exposure to creditors, may be exposed.

Suppose the powerholder of a non-presently exercisable general power exercises the power to appoint the property other than to the powerholder's or the powerholder's estate's creditors. The rights of those creditors are cut-off under this section but they may still have rights under the state's fraudulent transfer law. If the exercise is to pay off one or some creditors at the expense of others there is no state law right of redress for the unpaid creditors although there may be remedies available under federal bankruptcy law (a discussion of which is beyond the scope of these materials).

Section 502(b) and KRS § 390, Section 32(2) provides that a power of appointment created by a person other than the powerholder that is subject to an ascertainable standard relating to an individual's health, education, support, or maintenance within the meaning of section 2041(b)(1)(A) or 2514(c)(1) of the Code will be treated automatically as a nongeneral power.

(3) Crummey withdrawal rights are dealt with in § 503, which as discussed above is not included in the Kentucky version of the act, provides that a current right to withdraw assets from a trust is a presently exercisable general power of appointment. However, upon the lapse, release, or waiver of such power, the power will be treated as a presently exercisable general power only to the extent that it exceeds the annual exclusion amount. Under Kentucky law, it is arguable a power to withdraw falls under the definition of a power of appointment under KRS § 390, Section 1(13). However, there may be some conflict between this understanding and KRS § 386B.6-030(2) of the Uniform Trust Code, which grants "the holder of a power of withdrawal has the rights of a settlor of a revocable trust under this section to the extent of the property subject to the power." A further examination of this issue is outside the realm of these materials.

(4) Property subject to the exercise of a nongeneral power of appointment is not subject to the claims of the powerholder's creditors, per § 504 of the Uniform Act and Section 33 of KRS § 390, with one exceptions. Property subject to a nongeneral power is subject to the claim of a creditor of the powerholder or the powerholder's estate to the extent that the powerholder owned the property and transferred it in a fraudulent conveyance, reserving the nongeneral power. This is really an application of the fraudulent conveyance statutes that cause the property to be subject to the creditors, and the rule in the Uniform Act is merely to ensure that the presence of a nongeneral power does not affect that rule.

(5) The special case of elective share rights of a powerholder's surviving spouse is not dealt with by the Uniform Act or the newly enacted Kentucky statute because elective share rights are anything but uniform. Section 23 of the Restatement Third of Property sets forth what it believes would be good policy, namely that the powerholder is treated as owning property subject to a presently exercisable general power of appointment exercisable by the powerholder immediately before death and property subject to a general testamentary power of appointment exercisable by the powerholder if the powerholder was also the creator of the power. Essentially this would treat the surviving spouse as being similar to any other creditor. The Uniform Probate Code implements this policy in UPC sec. 2-205(1)(A) and (2)(A). Numerous states have adopted some version of this section in their elective share statutes. See, for example, Florida Statute § 732.2035 and Oregon Revised Statute § 114.665.

14. Definition of "person" in the Uniform Act.

The standard definition of "person" in uniform acts is used in the Uniform Act, in § 102(12) and KRS § 390, Section 1(12):

> "Person" means an individual, estate, trust, business or nonprofit entity, public corporation, government or governmental subdivision, agency, or instrumentality, or other legal entity.

This definition matters because powerholders are persons, appointees are persons, and donors—those who create powers—are persons. In short, in the Uniform Act one does not have to be an individual to create a power, have a power, exercise a power, or be the beneficiary of an exercise of a power. Note that the Uniform Trust Code contains a similar definition of "person" and allows trusts to be created by persons.

Consider a trust that gives a limited liability company a power of appointment. The ownership of the LLC could be transferred, thus changing who could control the exercise of the power. Undoubtedly for federal tax purposes the LLC would be looked through and the power treated as held by the owners of the LLC. Consider also a trust that allowed a powerholder to appoint assets to a particular LLC. Because the ownership of the LLC could change, the beneficiaries of the power could change as well, and the exercise of the power could be bought and sold. Rights of withdrawal are presently exercisable general powers of appointment; might there be circumstances where those powers would be better held by an LLC than by individuals?

To date, the only regular use of this expanded definition has been outside the area of powers of appointment. The Uniform Trust Code allows the settlor of a charitable trust to enforce its terms. If a charitably minded individual transfers assets to an LLC and the LLC creates the charitable trust, the LLC is the settlor of the trust for state law purposes, and in a UTC state that has not altered the uniform provisions the LLC may enforce the charitable trust. The LLC need not terminate when the individual who originally created it dies. We can expect additional uses to develop as the Uniform Act becomes widespread.