2021 Trust Advisors Forum

Hot Topics in Estate Planning

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HOT TOPICS IN ESTATE PLANNING[1]

LEGISLATIVE AND REGULATORY DEVELOPMENTS

1. Coronavirus Aid, Relief and Economic Security Act (the "CARES Act") (March 27, 2020)

Congress enacts legislation in response to the public health and economic crisis resulting from the Covid-19 pandemic

On March 27, 2020, President Donald Trump signed into law the Coronavirus Aid, Relief, and Economic Security Act (the CARES Act). The legislation was considered the third phase of legislation enacted in response to the public health and economic crisis resulting from the COVID-19 pandemic. Various provisions of the CARES Act are summarized below:

I. Rebate Checks for U.S. Residents

The CARES Act provides that all U.S. residents who have adjusted gross income below $75,000 ($150,000 if married) who are not dependents and who have a work-eligible social security number will receive a rebate on their taxes of $1200 ($2400 if married). There is an additional $500 rebate for each child. The rebates are decreased by $5 for each $100 in income up to $99,000 ($198,000 married with no children). Individuals with no income or income from non-taxable means-tested benefits programs, such as Social Security, are eligible for the rebates.

II. Retirement Plan Changes

The CARES Act makes two important changes with respect to retirement plans:

1. Waiver of Required Minimum Distribution Rules. The Act waives required minimum distributions from defined contribution plans (such as 401(k) plans) and Individual Retirement Accounts (IRA's). This includes distributions that would have been required by April 1, 2020, due to the account owner having reached age 70 ½ in 2019.

2. Waiver of Ten Percent Penalty for Early Distributions from Retirement Plans. The ten percent penalty for early distributions from defined contribution plans and IRA's is waived for distributions made between January 1, 2020 and December 31, 2020 if certain requirements are met. The penalty-free distributions cannot exceed $100,000. They are limited to individuals who himself or herself or whose family is infected with the Coronavirus or who is economically harmed by the Coronavirus. The taxable income from the distributions is spread out over three years (unless the recipient opts out of the

[1] These materials are based on materials prepared by Andrea Chomakos, W. Birch Douglas, III, Charles D. Fox IV, Kristen Hager, Meghan Gehr Hubbard, Sean Murphy, Stephen W. Murphy, and William I. Sanderson of McGuireWoods LLP.

three-year spread. If certain guidelines are met, the penalty-free distributions may recontributed to the plan or IRA.

III. Direct Financial Support Provisions for Businesses in the CARES Act

The CARES Act creates largely two different direct financial support mechanisms for businesses based on the size of the company.

1. Payroll Protection Program. The CARES Act allocated $350 billion to payroll protection for small businesses, nonprofit, or veteran's organization with less than 500 employees, or the applicable size standard for the industry as provided by SBA, if higher.

   a. The CARES Act allows for businesses that are classified as accommodation or food services to count the 500 employee maximum per physical location.

   b. Loan period is February 15, 2020 and ending June 30, 2020.

   c. Size of loan would equal 250 percent of employer's average monthly payroll. The maximum loan amount is $10 million through December 31, 2020.

   d. Allowable uses of the loan include: payroll support including employee salaries, paid sick or medical leave, insurance premiums, and mortgage, rent, and utility payments.

   e. Eligibility requirements:

      i. The business was operational on February 15, 2020.

      ii. The business had employees for whom it paid salaries and payroll taxes.

      iii. The borrowing business needs to make a good faith certification that the loan is necessary due to COVID-19, and it will use the funds to retain workers and maintain payroll, lease, and utility payments.

      iv. The business is not receiving duplicative funds for the same uses from another SBA program.

   f. Collateral and personal guarantee requirements are waived.

   g. If the employer maintains its payroll, then the portion of the loan used for covered payroll costs, interest on mortgage obligations, rent, and utilities will be forgiven.

   h. The maximum interest rate is set at four percent.

i. There is an expansion of Emergency Economic Injury Disaster Loans (EIDL) and the SBA is allowed to advance $10,000 within three days of application to help maintain payroll.

j. Increased SBA Express loan to $1 million

2. Other "Eligible Business" that has not otherwise received adequate economic relief in the form of loans or loan guarantees.

a. $454 billion for loans, loan guarantees, and investments through Federal Reserve 13(3) lending program. Passenger air carries received $25 billion, cargo air carriers received $4 billion, and national security business received $17 billion in direct lending.

i. Intended for companies between 500-10,000 employees.

ii. Funds required to be used to maintain at least 90% of recipient's workforce, at full compensation and benefits, through 9/30/20.

iii. Interest on loans not to exceed 2%, with no principal or interest payments due within 6 months.

iv. Within 4 months of termination of the public health emergency, a commitment to restore 90% of the workforce as it existed on 2/1/20.

v. Recipient will not outsource or offshore jobs for two years.

vi. Will not abrogate existing collective bargaining agreements for term of loan plus two years.

vii. Business must remain neutral in any union organizing effort for the term of the loan.

viii. All business applying for loans or loan guarantees under this provision must verify the business is not insolvent and is unable to obtain adequate financing elsewhere.

ix. Loan forgiveness is not permissible.

IV. CARES Act Tax and Debt Provisions

1. Delays in payment of employer payroll taxes. Allows employers to defer payment of the employer share of the Social Security tax with respect to their employees. The provision requires that the deferred employment tax be paid over the following two years.

2. Modifications for net operating loss. Provision provides that a loss from 2018, 2019, or 2020 can be carried back five years and temporarily removes the taxable income limitation to allow an NOL to fully offset income.

3. Modification of limitation on business interest. Temporarily increases the amount of interest expense businesses are allowed to deduct on their tax returns, by increasing the 30-percent limitation to 50 percent of the taxable income (with adjustments) for 2019 and 2020.

4. Fixes treatment of qualified improvement property. Enables businesses, especially in the hospitality industry, to write off immediately costs associated with improving facilities instead of having to depreciate those improvements over the 39-year life of the building.

5. Modification to the AMT. The provision accelerates the ability of companies to recover those AMT credits.

6. Temporary Relief from Troubled Debt Restructurings. Financial institution or federally-insured credit union may elect to suspend requirements under U.S. Generally Accepted Accounting Principles for loan modifications related to the coronavirus pandemic.

7. Creates a refundable payroll tax credit for 50 percent of wages paid by employers to employees during the COVID-19 crisis. The credit is available to employers whose (1) operations were fully or partially suspended, due to a COVID-19-related shut-down order, or (2) gross receipts declined by more than 50 percent when compared to the same quarter in the prior year. Up to the first $10,000 of compensation.

   a. For employers with more than 100 full-time employees, credit is for employees that were not providing services during the shut-down. For employers with less than 100 full-time employees, all employees' wages qualify for the credit whether they were open or shut-down during the outbreak.

8. Employers can provide a student loan repayment program on a tax-free basis. Employer may contribute up to $5,250 annually toward employee student loan and such a payment is not taxed.

V. Unemployment Insurance and Paid Leave Provisions in CARES Act

1. Increase in Unemployment Compensation Benefits. Provides an additional $600 per week payment to each recipient of unemployment insurance for up to four (4) months.

2. Expansion during 2020 for UI to cover individuals not otherwise covered by UI under a variety of conditions, including: COVID-19 diagnosis of the individual or a family

member, family care obligations and school closures, or self-quarantine advice from a health provider; eligibility includes individuals who are unable or unavailable to work (but not actually laid off or unemployed) because their place of employment is closed "as a direct result of the COVID-19 public health emergency"; this does not include employees who can telework with pay or who are receiving paid leave benefits.

3. Full Federal Funding of the First Week of Compensable Regular Unemployment for States with No Waiting Week.

4. Pandemic Emergency Unemployment Compensation. Provides an additional 13 weeks unemployment benefits through December 31, 2020 to help those who remain unemployed after weeks of state unemployment are no longer available.

5. Financing of Short-Time Compensation Payments. Provides funding to support "short-time compensation" programs, where employers reduce employee's hours instead of laying off workers and the employees with reduced hours receive a pro-rated unemployment benefit. This provision would pay 100 percent of the costs they incur in providing short-time compensation through December 31, 2020.

6. Employer shall not be required to pay more than $200 per day and $10,000 in the aggregate for each employee under the Family and Medical Paid Leave.

7. Employer shall not be required to pay more than $511 per day and $5,110 in the aggregate for sick leave or more than $200 per day and $2,000 in the aggregate to care for a quarantined individual or child for each employee.

8. Allows an employee who was laid off by an employer March 1, 2020, or later to have access to paid family and medical leave in certain instances if they are rehired by the employer. Employee would have had to work for the employer at least 30 days prior to being laid off.

9. Employers receive an advance tax credit from Treasury instead of having to be reimbursed on the back end for paid sick leave.

VI. Administrative Actions

1. On March 20, 2020, the Treasury Department, the Internal Revenue Service (IRS), and the U.S. Department of Labor (DOL) announced that small and midsize employers (under 500 employees) can begin taking advantage of two new refundable payroll tax credits, designed to immediately and fully reimburse them, dollar-for-dollar, for the cost of providing Coronavirus-related leave to their employees.

2. DOL published guidance explaining paid sick leave and expanded family and medical leave under the Families First Coronavirus Response Act.

3. Treasury announced the deferment of up to $10 million of federal income tax payments for corporate taxpayers until July 15, 2020.

VII. Additional Legislative Action

1. The first two emergency COVID-19 bills passed by Congress focused on healthcare funding and employees of small businesses.

2. Congress passed the first COVID-I9 package on March 6, 2020. The $8.3 billion emergency funding bill provided for disease treatment and prevention, vaccine development, telehealth, and grants to the states to help fight the virus. The bill also appropriated $20 million for small business loans.

3. Congress passed the second COVID-19 bill, The Families First Coronavirus Response Act, on March 18, 2020. The bill expanded emergency paid sick leave and family leave for employees at companies with fewer than 500 employees.

4. On April 24, 2020, the Paycheck Protection Program and Health Care Enhancement Act became law. This act provides additional funding for small business loans, healthcare providers, and COVID-19 testing.

5. One May 15, 2020, the House of Representatives passed the Health and Economic Recovery Omnibus Emergency Solutions ("HEROES") Act by a vote of 208-199. The HEROES Act has a projected cost of $3 trillion. It faces a difficult time in the Senate where many members of the Republican majority have declared it dead on arrival.

VIII. Business Tax Relief in the CARES Act

New Refundable Employee Retention Tax Credit. The new law provides eligible employers with a refundable payroll tax credit in an amount of 50 percent of eligible wages paid to employees during each calendar-year quarter for the period from March 13, 2020, through Dec. 31, 2020. Eligible employers are those employers whose (1) operations were fully or partially suspended as a result of a COVID-19 related shutdown order, or (2) gross receipts declined by more than 50 percent during a calendar-year quarter in 2020 when compared to the same quarter in 2019.

The credit is a maximum of $5,000 per employee, computed based on the first $10,000 of qualified wages (including compensation and health benefits) paid to each eligible employee during the specified period. The total credit for an employer may not exceed the total employment taxes for all employees for each calendar-year quarter. For employers with 100 or more full-time employees, qualified wages include wages paid to employees only when they are not providing services due to COVID-19 related circumstances. For employers with fewer than 100 full-time employees, all employee wages are qualified wages, regardless of whether the employer is open for business or subject to a shutdown order. Aggregation rules apply for purposes of determining whether entities under common control are treated as a single employer.

Employer Payroll Tax Deferral. The legislation contains a new provision allowing employers and self-employed individuals to defer payment of the employer share of the employment tax with respect to their employees during the remainder of the 2020 calendar year. The amount of the tax is generally 6.2 percent of employee wages subject to a wage ceiling. The new law permits any deferred tax to be paid over the following two-year period, with 50 percent of the deferred amount due by Dec. 31, 2021, and the other 50 percent by Dec. 31, 2022. The provision will treat employers as having made all required deposits during the interim period.

Changes to Net Operating Loss Limitations. The CARES Act temporarily reverses and modifies the changes made by the TCJA to Section 172 of the Code, which imposed limitations on the deductibility of net operating losses (NOLs) by businesses. The new law permits businesses to carryback NOLs generated in taxable years beginning after Dec. 31, 2017, and before Jan. 1, 2021, to the taxpayer's preceding five taxable years and allows the use of NOLs to offset 100 percent of a taxpayer's taxable income, temporarily removing the 80 percent taxable income limitation imposed by the TCJA for taxable years beginning before Jan. 1, 2021. A taxpayer may make an irrevocable election to waive the five-year carryback period for NOLs.

This new provision could be beneficial to taxpayers with net taxable income in prior years, allowing the carry back of 2018, 2019 and 2020 losses to offset pre-2018 taxable income that was taxed at rates of up to 35 percent, thereby generating a current refund. Taxpayers may also consider filing accounting method changes for 2019 or 2020 to accelerate deductions or defer revenue and thereby increase the NOLs in those years. In carrying back losses to earlier years, taxpayers will need to consider the impact to various tax calculations in those years, including the Section 163(j) interest deduction limitation and the Section 250(a)(2) limitation on the global intangible low-taxed income (GILTI)/foreign-derived intangible income (FDII) deduction.

Changes to "Excess Business Loss" Limitations. Following enactment of the TCJA, Section 461(l) of the Code prevented a taxpayer from deducting a net pass-through business loss in excess of $250,000 (or $500,000 in the case of taxpayers filing a joint return). The CARES Act repeals such excess loss limitation for tax years beginning prior to Jan. 1, 2021, with such repeal effective on a retroactive basis to Dec. 31, 2017 (i.e., for calendar years 2018, 2019 and 2020). The excess business loss limitation will now only apply for any tax year beginning after Dec. 31, 2020, and before Jan. 1, 2026. The provision also provides a technical correction to the TCJA to permit any limited excess business losses to be treated as NOL carryovers in a later year.

Acceleration of Corporate AMT Credits. The corporate alternative minimum tax (AMT) was repealed as part of the TCJA, but corporate AMT credits are allowed as refundable credits over several years, ending in 2021. This provision accelerates the ability of companies to recover the AMT credits, permitting companies to claim a refund now.

Modification of Business Interest Limitation. Under the TCJA, the amount of a taxpayer's business interest expense under Section 163(j) of the Code was limited to 30 percent of a taxpayer's adjusted taxable income (ATI). The CARES Act temporarily increases the limitation to 50 percent of ATI for 2019 and 2020, so taxpayers will be able to deduct more interest expense. A taxpayer may elect to use 2019 ATI in lieu of 2020 ATI for purposes of calculating the 2020 limitation.

Increased Charitable Contribution Limitation for 2020. For the 2020 taxable year, the new law increases the corporate limitation on charitable contribution deductions from 10 percent of taxable income to 25 percent of taxable income. In addition, the limitation on deductions for contributions of food inventory (e.g., those eligible for an enhanced charitable deduction) is increased from 15 percent to 25 percent.

Expensing for Qualified Improvement Property. The legislation classifies "qualified improvement property" as 15-year Modified Accelerated Cost Recovery System (MACRS) property, thereby allowing businesses to immediately deduct the costs associated with improving nonresidential real property, instead of being required to amortize such costs over the 39-year life of the building. This provision is a technical correction to the TCJA and is effective as of the enactment of the TCJA, allowing taxpayers to amend a prior-year return to claim a refund.

Temporary Excise Tax Exemption for Hand Sanitizer. The new law temporarily waives the federal excise tax on any distilled spirits used in or contained in hand sanitizer produced and distributed in a manner consistent with guidance issued by the Food and Drug Administration and is effective for calendar year 2020.

Temporary Federal Aviation Excise Tax Holiday. Effective upon the date of enactment through Dec. 31, 2020, the new law provides an exemption from the excise taxes imposed by Sections 4261 and 4271 of the Code for amounts paid for transportation by air of persons and property.

IX. CARES Act Provides Tax Relief to Encourage Charitable Giving in 2020

New Universal Charitable Contribution Deduction for Individuals. Because of the significant increase to the standard deduction for individuals after the enactment of the 2017 Tax Act, it is estimated that more than 85 percent of taxpayers will not claim itemized deductions on their federal income tax returns for tax year 2019. As a result, many people have learned they did not or will not receive any direct tax benefit for their 2019 charitable contributions and may not receive tax benefits for future years.

To encourage charitable giving among this group of taxpayers and to further support relief efforts, Congress included a provision in the CARES Act that creates a new partial above-the-line deduction for cash contributions up to $300 to certain charitable organizations for taxpayers that elect not to itemize deductions. Note that, for the contribution to be deductible, it must be given to a charitable organization described in Internal Revenue Code section 170(b)(1)(A). Qualifying donations do not include contributions to a supporting organization or to a sponsoring organization for the establishment of a new donor advised fund or to be added to an existing donor advised fund.

It remains uncertain whether Congress intended to allow this new charitable deduction for non-itemizers in future years, or if this is a one-time incentive as part of the COVID-19 disaster response. For now, the hope is that this change will benefit those nonprofits that traditionally rely upon a volume of smaller-level contributions, including those charities that provide direct services to the needy, healthcare organizations such as nonprofit hospitals, and religious organizations.

Raising the Limits on Deductions for Cash Charitable Contributions during 2020. The CARES Act temporarily modified the percentage limitations on the income tax charitable deduction for cash contributions to certain charities available to individuals who are itemizers and corporations if these taxpayers elect to have these provisions apply for the 2020 tax year. For 2020, individuals may deduct qualified contributions to the extent of their contribution base (i.e., the individual's 2020 adjusted gross income without regard to any net operating loss carryback to 2020). This provision is very favorable to those donors who wish to make large cash contributions in 2020, the deductibility of which might otherwise have been curbed due to the percentage limitations. The election would allow much more to be deducted in 2020 and less carried forward for deduction in future years.

For corporations, the percentage limitation on the corporate income tax charitable deduction increased from 10 to 25 percent of the corporation's taxable income for 2020. In the case of charitable contributions by partnerships or S corporations, each partner or shareholder must separately elect to use the modified percentage limitations.

Any charitable contribution exceeding the limits discussed above may be carried forward and used in later years subject to certain limits.

Exclusions. Charitable contributions carried over from a prior tax year (before 2020) are excluded from this temporary relief and are subject to previous limitations in the tax code. And charitable contributions to private non-operating foundations, supporting organizations and sponsoring organizations to fund donor advised funds do not qualify for the modified percentage limitations for 2020.

Food Donations. Finally, the CARES Act raises the applicable limits on the amount of the allowed deduction for food inventory from 15 percent to 25 percent for the taxable year, thereby encouraging donations of food to organizations that provide for those in need.

2. Consolidated Appropriations Act, 2021 (December 27, 2020)

Congress extends charitable benefits first provided by CARES Act

Congress passed the Consolidated Appropriations Act, 2021 on December 21, 2020 by wide bipartisan majorities in both the House of Representatives and the Senate. This Act provided another round of stimulus provisions to address the effects of the COVID-19 Pandemic and funded the operations of the government. President Trump signed the legislation on December 27, 2020.

In the charitable area, the Act extended the $300 charitable deduction for non-itemizers through 2021 and increased the deduction to $600 for joint filers in 2021.

The Act extended the 100 percent of Adjusted Gross Income limitation for gifts of cash to public charities through December 31, 2021.

The Act extended the 25 percent limitation on corporate charitable deductions (increased from 10 percent by the CARES Act) and the 25 percent limitation on contributions of food inventory (increased from 15 percent by the CARES Act) through December 31, 2021.

The Act also (1) reaffirms that the forgiveness of a PPP loan is not included in gross income for US federal income tax purposes and (2) provides that a deduction shall not be denied by reason of that exclusion.

3. Notice 2020-17, 2020-15 IRB 590 (March 18, 2020); Notice 2020-18, 2020-15 IRB 592 (March 23, 2020); Notice 2020-20, 2020-16 IRB ____ (March 27, 2020); Notice 2020-23, 2020-18 IRB _____(April 9, 2020)

Treasury Department extends due dates for the filing of various tax returns and the payment of tax owed

The series of notices outlines the decisions made by the Treasury Department over a three week period to extend the due dates for the filing of various tax returns and the payment of taxes from April 15, 2020 to July 15, 2020.

Notice 2020-17 was issued by the Treasury Department on March 18, 2020 and postponed the payment of certain income taxes to July 15, 2020, but not the filing of the underlying tax returns.

Notice 2020-18 was issued by the Treasury Department on March 23, 2020 to supersede Notice 2020-17. Notice 2020-18 provides that the due date for filing federal income tax returns and making federal income tax payments due April 15, 2020 was automatically postponed to July 15, 2020. There was no limitation on the amount of the payment that could be postponed. The Notice applied to federal income tax payments and estimated income tax payments. No interest or penalty would be imposed as a result of the postponement. Notice 2020-18 applies to individuals, trusts, estates, partnerships, associations, companies, or corporations.

In Notice 2020-20, the Treasury Department amplified Notice 2020-18 and determined that any gift tax or generation-skipping tax payment due or any gift or generation-skipping tax returns due on April 15, 2020, would be automatically postponed to July 15, 2020. There is no requirement to file a Form 8892 (Application for Automatic Extension of Time) to obtain the benefit of the filing and payment postponement. However, a taxpayer could file a Form 8892 by July 15, 2020, to obtain an extension to file the gift tax return by October 15, 2020 but any gift or generation-skipping tax would still be due on July 15, 2020. No interest or penalty would be imposed with respect to any return or tax now due on July 15, 2020.

The Treasury Department subsequently issued Notice 2020-23 to further expand upon the prior Notices. Notice 2020-23, among other steps, extended the deadline for filing of fiduciary income tax returns and the payment of fiduciary income tax returns for estates and trusts to July 15, 2020 and the filing of estate tax returns. It may also apply to estate and generation-skipping tax payments owed because of the filing of estate tax return and the payment of any estate and generation-skipping tax otherwise due between April 15, 2020, and July 15, 2021.

Finally, the IRS has posted additional guidance on its website on these issues involving estate and gift tax and fiduciary income tax returns. See https://www.irs.gov/businesses/small-businesses-self-employed/covid-19-relief-for-estate-and-gift.

4. Setting Every Community Up for Retirement Enhancement ("SECURE") Act (December 17, 2019)

Secure Act has large impact on retirement benefits

The House of Representatives on December 17, 2019 and the Senate on December 19, 2019 passed the Setting Every Community Up for Retirement Enhancement ("SECURE") Act as part of Division O of H.R. 1865, which was entitled "Further Consolidated Appropriations Act, 2020." The SECURE Act was introduced by House Ways and Means Chair Richard Neal and Ranking Member Kevin Brady and was passed on a bipartisan basis. The SECURE Act includes the following changes to defined compensation plans, defined benefit plans, and IRAs:

- Making it easier for small businesses to set up 401(k) accounts;

- Providing a maximum tax credit of $500 per year to employers who create a 401(k) or simple IRA with automatic enrollment;

- Pushing back the age at which retirement plan participants need to take required minimum distributions from 70 ½ to 72;

- Removing the age limit at which an individual can contribute to a regular IRA and allowing anyone that is working and has earned income to contribute to a regular IRA regardless of age;

- Requiring most non-spousal IRA retirement plan beneficiaries to withdraw the amounts in inherited accounts within 10 years of the death of the participant.

This last change, which will be effective for anyone who inherited an IRA from the original IRA owner who passed away on or after January 1, 2020, basically eliminates the use of the "Stretch

IRA" by most non-spousal individual beneficiaries. Far fewer beneficiaries will be able to extend distributions from an inherited IRA over their lifetimes. Instead, most beneficiaries of inherited IRAs will have to withdraw all of the assets from the inherited IRA within ten years following the death of the original owner. The exceptions to the ten-year distribution requirement include IRAs left to a surviving spouse, a minor child, a disabled or chronically ill individual, and beneficiaries who are less than 10 years younger than the decedent.

The new law also now permits tax-free distributions from a 529 plan to repay up to $10,000 in qualified student loans and the expenses of certain apprenticeship programs. This change to 529 plans is retroactively effective as of January 1, 2019.

The new law also reinstates the pre-2017 Kiddie Tax rules so the tax of unearned minors and dependents is taxed at the parents' marginal rates and not at the rates applicable to irrevocable non-grantor trusts and estates.

5. H.R. 8696 – Securing a Strong Retirement Act of 2020 (October 27, 2020)

Bipartisan bill introduced to expand SECURE Act

The Chair of the House Ways and Means Committee, Richard Neal (D-MA), and the ranking member of the Ways and Means Committee, Kevin Brady (R-TX), have introduced the "Securing a Strong Retirement Act of 2020." The bill will expand on the Setting Every Community up for Retirement Enhancement Act ("SECURE Act") which Congress enacted in December 2019 with broad bipartisan support.

This new act makes the following changes:

- Expands automatic enrollment in 401(k), 403(b) and simple plans to eligible participants with an initial automatic enrollment amount between 3 percent and 10 percent.

- Simplifies the Saver's Credit by creating one 50 percent rate as opposed to 3 tiers and increasing the maximum credit amount from $1,000 to $1,500.

- Increases the age for Required Minimum Distributions (RMDs) from 72 to 75.

- Extends the deferral of tax on capital gains for Employee Stock Ownership Plans ("ESOPS") to S Corporations.

- Indexes the catch up limit on IRA contributions beginning in 2022.

- For individuals age 60 and above, indexes and raises the catch up limit to retirement plans to $10,000.

- Allows 403(b) plans to participate in multiple employer pension plans; and allows employers to match 401(k), 403(b) and simple IRA contributions with respect to "qualified student loan payments".

- Reduces the penalty for failing to pay RMDs from 50% to 25%, which penalties would be further reduced if corrected in a "timely manner."

- Exempts plan participants from RMDs, if their retirement plan contains less than $100,000 on December 31 of the year before they turn 75.

- Allows a one-time IRA distribution to charities up to $130,000.

Given the bipartisan support of the SECURE Act in 2019, it is likely that this bill will pass at some point in 2020 or in 2021.

6. President Biden's Tax Proposals

Proposals made by President Biden during the election campaign could have major impact on taxes if enacted as proposed

Some of the proposals made by President Biden in policy papers and pronouncements during the 2020 Presidential campaign include;

1. Increasing the top income tax rate for taxable incomes above $400,000 from 37 percent to 39.6 percent (pre-2017 Tax Act highest rate).

2. 12.4 percent Social Security tax on earned income above $400,000 to be split evenly between employers and employees.

3. Taxing long-term capital gains and qualified dividends at the ordinary income tax rate of 39.6 percent on incomes above $1,000,000.

4. Eliminating the step-up in basis at death for capital gains taxation and taxes the appreciation at transfers. This proposal appears to create a capital gains tax at death and possibly when appreciated assets are gifted during life.

5. Capping the benefit of itemized deductions to 28 percent of value for those earning more than $400,000.

6. Restoring the Pease limitation on itemized deductions for taxable incomes above $400,000.

7. Phasing out the Section 199A qualified income business deduction for taxpayers with income over $400,000.

8. Expanding the Earned Income Tax Credit for childless workers age 65+

9. Restoring the estate and gift tax rates and exemptions to 2009 levels. This would mean a fixed $3,500,000 estate and generation-skipping tax exemption and a fixed $1,000,000 gift tax exemption with a top rate of 45 percent on amounts over $1,500,000.

10. Increasing the corporate income tax rate from 21 percent to 28 percent.

7. For the 99.8 Percent Act, S. 309 (Introduced January 31, 2019) and H.R. 4857 (Introduced October 24, 2019)

Senator Sanders and Representative Gomez introduce identical bills to change the estate tax

On January 31, 2019, Senator Bernie Sanders (I. Vt.) introduced the "For the 99.8 Percent Act" in the United States Senate. Almost nine months later, Representative Jimmy Gomez (D. Cal.) introduced the Act in the United States House of Representatives. These bills, if ever enacted, would greatly impact the estate, gift, and generation-skipping taxes.

The Act would have a non-indexed $3.5 million exemption for estate tax (and presumably generation-skipping) tax purposes. The non-indexed gift tax exemption would be $1 million. The Act includes anti-clawback rules. The proposed marginal rates are:

$3.5 million to $10 million	45%
$10 million to $50 million	50%
$50 million to $1 billion	55%
Over $1 billion	77%

The Section 2032A special valuation rule cap would be increased from $750,000 indexed for inflation since 1997 to $3 million indexed for inflation since 1997 or about $4.6 million in 2020. The Section 2031(c)(1) maximum exclusion for land subject to a conservation easement would be increased from the lesser of $500,000 or forty percent of the net value to the lesser of $2 million or sixty percent of the net value. The consistent basis reporting rules of Section 1014(f) for estates would be extended to gifts.

The Act restricts the availability of discounts for entities such as limited partnerships and limited liability companies. If an interest in an entity that is not actively traded is transferred for estate and gift tax purposes, the nonbusiness assets held by the entity would be valued as transferred directly from the transferor to the transferee. Also, no lack of control discount would be allowed if the transferor, the transferee, and members of their family or families control the entity or own a majority of the entity's ownership interests by value.

A new Chapter 16 and a new Section 2901 would eliminate many of the benefits of planning with grantor trusts for third party beneficiaries by treating any distribution during the deemed grantor's live as a gift, treating the cessation of grantor trust status as a gift, and including the value of the assets at the deemed grantor's death in the deemed grantor's estate.

The Act eliminates zero-out GRATs. GRATs would be subject to a ten year minimum term with no decrease permitted in the annual payment. The maximum term would be the grantor's life expectancy plus ten years. The minimum value of the remainder interest in the GRAT would be the greater of twenty-five percent of the value transferred or $500,000 but not greater than one hundred percent of the value transferred.

The Act would impose an inclusion ratio of one for generations-skipping tax purposes for any trust that is not a "qualifying trust." A qualifying trust is one that must terminated within fifty years after creation. A trust created before the date of enactment would receive an inclusion ratio of one for fifty years after the date of enactment and would be thereafter subject to generation-skipping tax.

The gift tax annual exclusion would be simplified to apply to transfers in trust, transfers of interests in pass-through entities, and transfers subject to prohibitions or other restrictions. These changes basically eliminate the current present interest requirement for annual exclusion gifts. There would be an annual $30,000 per donor limit. The Act retains the exclusion for the payment of tuition and medical expenses directly to the provider.

8. **Revenue Procedure 2020-45 (October 26, 2020)**

IRS announces inflation adjustments for 2021

The following are some of the inflation adjustments for 2021.

1. Tax Rate Tables

TABLE 1 – Married Individuals Filing Joint Returns and Surviving Spouses

If Taxable Income is:	The Tax is:
Not over $19,900	10% of the taxable income
Over $19,900 but not over $81,050	$1,990 plus 12% of the excess over $19,900
Over $81,050 but not over $172,750	$9,328 plus 22% of the excess over $81,050
Over $172,750 but not over $329,850	$29,502 plus 24% of the excess over $172,750
Over $329,850 but not over $418,850	$67,206 plus 32% of the excess over $329,850
Over $418,850 but not over $628,300	$95,686 plus 35% of the excess over $418,850

Over $628,300	$168,993.50 plus 37% of the excess over $628,300

TABLE 2 – Heads of Household

If Taxable Income is:	The Tax is:
Not over $14,200	10% of the taxable income
Over $14,200 but not over $54,200	$1,420 plus 12% of the excess over $14,200
Over $54,200 but not over $86,350	$6,220 plus 22% of the excess over $54,200
Over $86,350 but not over $164,900	$13,293 plus 24% of the excess over $86,350
Over $164,900 but not over $209,400	$32,145 plus 32% of the excess over $164,900
Over $209,400 but not over $523,600	$46,385 plus 35% of the excess over $209,400
Over $523,600	$156,355 plus 37% of the excess over $523,600

TABLE 3 – Unmarried Individuals (other than Surviving Spouses and Heads of Household)

If Taxable Income is:	The Tax is:
Not over $9,950	10% of the taxable income
Over $9,950 but not over $40,525	$995 plus 12% of the excess over $9,950
Over $40,525 but not over $86,375	$4,664 plus 22% of the excess over $40,525
Over $86,375 but not over $164,925	$14,751 plus 24% of the excess over $86,375
Over $164,925 but not over $209,425	$33,603 plus 32% of the excess over $164,925
Over $209,425 but not over $523,600	$47,843 plus 35% of the excess over $209,425
Over $523,600	$157,804.25 plus 37% of the excess over $523,600

TABLE 4 – Married Individuals Filing Separate Returns

If Taxable Income is:	The Tax is:

Not over $9,950	10% of the taxable income
Over $9,950 but not over $40,525	$995 plus 12% of the excess over $9,950
Over $40,525 but not over $86,375	$4,664 plus 22% of the excess over $40,525
Over $86,375 but not over $164,925	$14,751 plus 24% of the excess over $86,375
Over $164,925 but not over $209,425	$33,603 plus 32% of the excess over $164,925
Over $209,425 but not over $314,150	$47,843 plus 35% of the excess over $209,425
Over $314,150	$84,496.75 plus 37% of the excess over $314,150

TABLE 5 – Estates and Trusts

If Taxable Income is:	The Tax is:
Not over $2,650	10% of the taxable income
Over $2,650 but not over $9,550	$265 plus 24% of the excess over $2,650
Over $9,550 but not over $13,050	$1,921 plus 35% of the excess over $9,550
Over $13,050	$3,146 plus 37% of the excess over $13,050

2. Standard Deductions

For taxable years beginning in 2021, the standard deduction amounts under Section 63(c)(2) are as follows:

Filing Status	Standard Deduction
Married Individuals Filing Joint Returns and Surviving Spouses	$25,100
Heads of Households	$18,800
Unmarried Individuals (other Than Surviving Spouses and Heads of Households)	$12,550

Married Individuals Filing Separate Returns	$12,550

3. Qualified Business Income Under Section 199A

For taxable years beginning in 2021, the threshold amount under Section 199(e)(2) is $329,800 for married filing joint returns, $164,925 for married filing separate returns, and $164,900 for single and head of household returns.

4. Basic Exclusion Amount

For an estate of any decedent dying in calendar year 2021, the basic exclusion amount is $11,700,000 for determining the amount of the unified credit against estate tax under Section 2010. The unified credit is $4,625,800.

5. Annual Exclusion for Gifts

(1) For calendar year 2021, the first $15,000 of gifts to any person (other than gifts of future interests in property) are not included in the total amount of taxable gifts under Section 2503 made during that year.

(2) For calendar year 2021, the first $159,000 of gifts to a spouse who is not a citizen of the United States (other than gifts of future interests in property) are not included in the total amount of taxable gifts under Section 2503 and 2523(i)(2) made during that year.

6. Interest on a Certain Portion of the Estate Tax Payable in Installments.

For an estate of a decedent dying in calendar year 2021, the dollar amount used to determine the "2-percent portion" (for purposes of calculating interest under Section 6601(j)) of the estate tax extended as provided in Section 6166 is $1,590,000.

9. 2020-2021 Priority Guidance Plan (November 17, 2020)

Treasury Department and Internal Revenue Service release their 2020-2021 Priority Guidance Plan

On November 17, 2020, the Treasury Department and the Internal Revenue Service released their 2020-2021 Priority Guidance Plan which lists those projects which will be the focus of the IRS's efforts during the twelve-month period from July 1, 2020 through June 30, 2021. The 2020-2021

Priority Guidance Plan contains 191 guidance projects of which guidance on 57 items had been released as of September 30, 2020.

The following items deal with guidance in the estate, gift, generation-skipping, fiduciary income tax, and related areas. Each item listed below is identified by the number given in the different parts of the Priority Guidance Plan.

Part 1 of the Plan is titled "Implementation of Tax Cuts and Jobs Act (TCJA)." The estate and gift tax and related item in Part 1 is:

4. Regulations clarifying the deductibility of certain expenses described in Sections 67(b) and (e) that are incurred by estates and non-grantor trusts. Final regulations were published on September 21, 2020.

   This item was carried over from the 2019-2020 Priority Guidance Plan.

Part 3. Burden Reduction. This part contains the following items dealing with estate and gift tax and related areas:

6. Guidance under Section 170(e)(3) regarding charitable contributions of inventory.

10. Final regulations streamlining the Section 754 election statement. Proposed regulations were published on October 12, 2017.

14. Final regulations under Sections 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.

18. Final regulations under Sections 2642(g) describing the circumstances and procedures under which an extension of time will be granted to allocate GST exemption.

20. Guidance under Treas. Reg. §301.9100 regarding relief for late regulatory elections.

   These items were carried over from the 2020-2021 Priority Guidance Plan.

Part 6. General Guidance. The section on gifts and estates and trusts in Part 6 includes the following items:

1. Guidance on the basis of grantor trust assets at death under Section 1014.

2. Guidance on the user fee for estate tax closing letters under Sections 2001.

3. Regulations under Section 2032(a) regarding the imposition of restrictions on estate assets during the six-month alternate valuation period. Proposed regulations were published on November 18, 2011.

4. Regulations under Section 2053 regarding personal guarantees and the application of present value concepts in determining the deductible amount of expenses and claims against the estate.

5. Regulations under Section 7520 regarding the use of actuarial tables in valuing annuities, interest for life or terms of years, and remainder or reversionary interests.

Items 2 and 4 are new. The other items were carried over from the 2019-2020 Priority Guidance Plan.

10. **Final Treasury Regulation § 20.2010-1(c) (November 22, 2019)**

Treasury Department issues final anti-clawback regulations

Proposed Regulations (REG-106706-18) were released on November 20, 2018, and published in the Federal Register on November 23, 2018 (83 Fed. Treas. Reg. 59343), to prevent the "clawback" of the benefits of the doubled federal gift tax exemption during 2018 through 2025 if the "sunset" of those benefits occurs in 2026 as currently scheduled and the donor dies in 2026 or later. Final Regulations were issued on November 22, 2019. Although neither the statute nor the final regulations use the word "clawback," the regulations would carry out the mandate of the 2017 Tax Act in new Section 2001(g)(2), which provides that Treasury "shall prescribe such regulations as may be necessary or appropriate to carry out this Section with respect to any difference between (A) the basic exclusion amount under Section 2010(c)(3) applicable at the time of the decedent's death, and (B) the basic exclusion amount under such Section applicable with respect to any gifts made by the decedent."

The final regulations would add a new paragraph (c) to Treas. Reg. § 20.2010-1 (with the current paragraphs (c) through (e) redesignated as (d) through (f)), providing that if the total of the unified credits attributable to the basic exclusion amount that are taken into account in computing the gift tax payable on any post-1976 gift is greater than the unified credit attributable to the basic exclusion amount that is allowable in computing the estate tax on the donor's estate, then the amount of the credit attributable to the basic exclusion amount that is allowable in computing that estate tax is not determined under Section 2010(c) but is deemed to be that greater total of gift tax unified credits attributable to the basic exclusion amount.

Example. Final Treas. Reg. § 20.2010-1(c)(2) provides the following Example:

"Individual A (never married) made cumulative post-1976 taxable gifts of $9 million, all of which were sheltered from gift tax by the cumulative total of $10 million in basic exclusion amount allowable on the dates of the gifts. A dies after 2025 and the basic exclusion amount on A's date of death is $5 million. A was not eligible for any restored exclusion amount pursuant to Notice 2017-15. Because the total of the amounts allowable as a credit in computing the gift tax payable on A's post-1976 gifts (based on the $9 million basic exclusion amount used to determine those credits) exceeds the credit based on the $5 million basic exclusion amount applicable on the decedent's date of death, under paragraph (c)(1) of this Section, the credit to be applied for purposes of computing the estate tax is based on a basic exclusion amount of $9 million, the amount used to determine the credits allowable in computing the gift tax payable on the post-1976 gifts made by A."

Viewed another way, if what would otherwise be the basic exclusion amount for estate tax purposes is less than the total of the basic exclusion amount applied to post-1976 taxable gifts, it is increased for estate tax purposes under this new regulation to equal that total. And if, in the example, the gift had been $12 million instead of $9 million, then the entire assumed $10 million basic exclusion amount would be used with still some gift tax payable (the donor having never married), and the estate tax credit would be computed as if the basic exclusion amount were $10 million.

Under Final Treas. Reg. § 20.2010-1(f)(2), the anti-clawback rule would take effect when it is adopted as a final regulation.

Contemporaneously with the release of the proposed regulations in November 2018, the IRS issued a news release with the reassuring headline of "Treasury, IRS: Making large gifts now won't harm estates after 2025." The press release includes an even simpler explanation that "the proposed regulations provide a special rule that allows the estate to compute its estate tax credit using the higher of the BEA [basic exclusion amount] applicable to gifts made during life or the BEA applicable on the date of death."

In their practical effect, the final regulations do what the statute asks – nothing more, nothing less. The statute compares a transfer at death after 2025 (subparagraph (A)) with a transfer by gift before 2026 (subparagraph (B)). And this is what the final regulation would address. For example, the final regulation would not address the similar scenario of gifts both before 2026 and after 2025. If large amounts of the increased credit attributable to the new doubled basic exclusion amount are used to shelter gifts from gift tax before 2026 (like the $9 million gift in the Example), then after 2025 the donor might have to wait for decades for the indexed $5 amount to catch up so there can be more credit available for gift tax purposes.

Likewise, the text of the regulation and the Example (and the description above in this Alert) are painstakingly limited in all cases to the amount of the credit that is attributable to the basic exclusion amount – that is, the amount (indexed since 2012) defined in Section 2010(c)(3). Regarding portability, for example, that approach makes it clear that the deceased spousal unused exclusion amount (DSUE amount) defined in Section 2010(c)(4) is not affected by this special rule and is still added under Section 2010(c)(2)(B), in effect thereby generating an additional credit of its own in cases in which the anti-clawback rule applies. But it still may be that the words "lesser of" in Section 2010(c)(4) will limit the DSUE amount available to the estate of a person who dies after 2025 (assuming no change in the law) to the sunsetted basic exclusion amount of $5,000,000 indexed for inflation in effect at the time of the death of the surviving spouse referred to in Section 2010(c)(4)(A), despite the assertion in Treas. Reg. § 20.2010-2(c)(1) that "the DSUE amount of a decedent with a surviving spouse is the lesser of the following amounts – (i) The basic exclusion amount in effect in the year of the death of the decedent" (presumably the predeceased decedent), and despite the statement in the preamble to the June 2012 temporary regulations that "[t]he temporary regulations in Treas. Reg. § 20.2010-2T(c)(1)(i) confirm that the term 'basic exclusion amount' referred to in Section 2010(c)(4)(A) means the basic exclusion amount in effect in the year of the death of the decedent whose DSUE amount is being computed." That limitation gives effect to the general notion held by congressional drafters that portability should, in effect, be allowed to no more than double what would otherwise be the survivor's exemption.

But if the final regulations follow the statute very closely as to their practical effect, it is harder to say that they follow the context of the statute as to their approach and form. Before the final regulations were released, there was speculation that the regulations under Section 2001(g)(2) would mirror Section 2001(g)(1) with which their statutory authority is linked and provide, in effect, that in calculating the estate tax the basic exclusion amount in effect at the time of death will be used to calculate the hypothetical "total gift tax paid or payable" on pre-2026 adjusted taxable gifts that is deducted under Section 2001(b)(2) on line 7 of Part 2 of the estate tax return. And by increasing the amount on line 7, which is subtracted in line 8, the estate tax would be appropriately reduced to offset the clawback effect.

But the final regulations take a different approach. The preamble implies that other approaches were considered, but concludes that "in the view of the Treasury Department and the IRS, the most administrable solution would be to adjust the amount of the credit in Step 4 of the estate tax determination required to be applied against the net tentative estate tax." In the context of the new regulation, "Step 4" in the preamble apparently most closely corresponds to line 9a of Part 2 of the estate tax return ("basic exclusion amount"); Step 2 corresponds to line 7.

By increasing the amount on line 9a, rather than the amount on line 7, the final regulations would achieve the same result, of course, because both line 7 and lines 9a through 9e produce subtractions in the estate tax calculation. But line 7 already requires three pages of instructions, including a 24-line worksheet, to complete, and an incremental increase of complexity in what already has a reputation for being a tangled morass might be easier to process than adding a new challenge to line 9, which now requires less than one-third of a page of instructions. But, needless to say, IRS personnel see more returns than we do, they see the mistakes, and they hear the complaints. Presumably – hopefully – they contributed to forming the assessment that the line 9 approach is "the most administrable solution."

That approach should work fine if the law is not changed and sunset occurs January 1, 2026. But, although the example in Final Treas. Reg. § 20.2010-1(c)(2) mentions that the donor "dies after 2025," the substantive rule in Final Treas. Reg. § 20.2010-1(c) applies by its terms whenever "changes in the basic exclusion amount … occur between the date of a donor's gift and the date of the donor's death." It is not limited to 2026 or to any other particular time period. The 2010 statutory rule in Section 2001(g)(1) and the 2017 statutory rule in Section 2001(g)(2) are not limited to any time period either. Therefore, if Congress makes other changes in the law, particularly increases in rates or decreases in exemptions, and doesn't focus on the potential clawback issue in the context of those changes, the generic anti-clawback regime of Section 2001(g)(1) and (2) and these regulations could produce a jigsaw puzzle of adjustments going different directions that may strain the notion of administrability cited in the preamble.

The Example in Final Treas. Reg. § 20.2010-1(c)(2) is generally helpful, mainly because it is simpler and more readable than the rule in Final Treas. Reg. § 20.2010-1(c)(1) itself. But, perhaps to help achieve that simplification, the drafters of the example used unindexed basic exclusion amounts of $10 million before 2026 and $5 million after 2025, thereby rendering it an example that could never occur under current law, and possibly causing concern that the final anti-clawback rule would apply only to the unindexed basic exclusion amount. Because the inflation adjustment is an integral part of the definition of "basic exclusion amount" in Section 2010(c)(3), there should be no question that it is the indexed amount that is contemplated and addressed by the regulation, despite the potential implication of the example.

In any event, the final regulations could benefit from more examples than just one, showing how the outcome would adapt to changes in the assumptions, including examples with indexed numbers, examples with numbers below $5 million (indexed) and above $10 million (indexed), examples with portability elections, and examples with allocations of GST exemption.

There had also been speculation that the regulations might address the option of making, for example, a $5 million gift during the 2018-2025 period (assuming no previous taxable gifts) and treating that gift as using only the temporary "bonus" exclusion resulting from the 2017 Tax Act, which is sometimes described as using the exclusion "off the top," still leaving the exclusion of $5 million (indexed) to generate a credit to be used against the estate tax after 2025. But that type of relief would go beyond the objective of preserving the benefits of a 2018-2025 use of the increase in the basic exclusion amount and would, in effect, extend the availability of those benefits beyond 2025. Although the preamble to the final regulations does not refer directly to that issue, it appears that it would require a different regulatory analysis to achieve that result.

The Notice of Final Rulemaking asked for comments from the public by February 21, 2019, and announces a public hearing to be held, if requested, on March 13, 2019.

11. **Letter Rulings 202018002 (Issued November 19, 2019; Released May 5, 2020) and 202046006 (Issued June 24, 2020; Released November 13, 2020)**

Decedent's estate granted extension to make portability election

These letter rulings are some of the most recent, almost identical letter rulings in which the IRS has granted the estate of the first spouse to die an extension of time to make the portability election.

Decedent died survived by spouse. Decedent's estate was not required to file an estate tax return. Decedent had unused applicable exclusion and a portability election was necessary to allow the surviving spouse to take into account that unused applicable exclusion (DSUE amount). Since the availability of portability in 2011, the portability election is to be made on a timely filed complete and properly prepared estate tax return. Spouses' tax advisor did not advise her about the portability election. Consequently, an estate tax return was not timely filed and the portability election was not made.

After the discovery of the missed portability election, decedent's estate requested an extension of time under Treas. Reg. § 301.9100-3 to make the portability election. Treas. Reg. § 301.9100-3 provides that an extension of time to make an election when the due date is prescribed by a regulation (and not expressly provided by statute) will be granted when the taxpayer provides evidence to establish that the taxpayer acted reasonably and in good faith and that granting the relief will not prejudice the interests of the government. Because the time for filing the portability election is fixed by the regulations, the Internal Revenue Service had the discretionary authority under Treas. Reg. § 301.9100-3 to grant an extension of time.

Based on the information, affidavits, and representations submitted on behalf of the decedent's estate, the Service granted the request for an extension of time. The Service did note that if it was later determined that decedent's estate was large enough to require the filing of an estate tax return, the Service lacked the authority under Treas. Reg. § 301.9100-3 to grant an extension of time to elect portability. In that situation, the extension of time to elect portability would be deemed null and void.

12. **FR Document 2020-28931 (December 29, 2020)**

Internal Revenue Service proposes $67 user fee for closing letter for federal estate tax returns

The Internal Revenue Service on December 31, 2020 proposed amendments to Treas. Reg. § 300 to add a new Treas. Reg. § 300.13 to impose a $67 fee for the issuance of estate tax closing letters. The Service decided to impose a $67 user fee for closing letters because of resource constraints and because issuing closing letters is a convenience to the estates requesting them.

The Service issues estate tax closing letters to authorized persons such as an executor or an executor substitute upon the request of the authorized person only (i) after the Service has accepted the return as filed; (ii) after the estate has agreed to an adjustment; or (iii) after an adjustment in the deceased spousal unused exclusion (DUSE) amount.

The Service indicated its understanding of the important role of the acceptance of the estate tax return with respect to state and local requirements in the administration and closing of a probate estate, making final distributions, and avoiding potential personal liability for unpaid estate tax in making distributions. However, the Service also noted that an estate tax closing letter does not indicate whether the estate tax has been paid or the amount of the estate tax that has been paid.

Although a closing letter is not a formal closing agreement under Section 7121, pursuant to Rev. Proc. 2005-32, 2005-1 C. B. 1206, the Service will not reopen or examine the estate tax return after the issuance of a closing letter unless the estate notifies the Service of changes in the estate tax return or there is (i) evidence of fraud, malfeasance, collusion, concealment, or misrepresentation of a material fact, (ii) a clearly defined substantial error based upon an established IRS position, or (iii) a serious administrative omission. The closing letter does not limit or foreclose the IRS to making future adjustments to the DSUE amount shown on the estate tax return and the returns can be examined in the future for portability purposes. A closing letter also explains the potential applications of Sections 6166 and 6324A (installment payments and special extended lien), 2204 (discharge of personal liability, and 6324 (estate tax lien).

Prior to June 1, 2015, the Service generally issued an estate tax closing letter for each estate tax return filed. For returns filed on or after June 1, 2015, the Service only issues estate tax closing letters upon the request of an authorized person. The Service changed its position in 2015 for two reasons. First, because of portability, the number of estate tax returns filed increased at the same time that the Service faced "budget and resource constraints." Second, the Service recognized that an account transcript with a transaction code and explanation of "421-Closed examination of tax return" is an available alternative to the closing letter. Prior to the COVID-19 pandemic, the authorized person could request a closing by letter or fax. Now, because of restrictions due to the COVID-19 pandemic, an authorized person can only request a closing letter by fax.

The Service noted that in 2016, the number of estate tax returns filed solely to elect portability of the DSUE amount was approximately 20,000 compared to the approximately 12,000 returns required to be filed because the estates equaled or exceeded that year's basic exclusion amount of $5,450,000. In 2018, when the basic exclusion amount was $11, 180,000, approximately 30,500 returns were filed with a large number of returns filed solely to elect portability of the DSUE amount.

The Service determined the $67 amount of the user fee based upon the full cost of issuing closing letters for a year of $1,160,058 divided by an estimated volume of 17,249.

The Service has sought comments by March 1, 2021.

MARITAL DEDUCTION

13. **Letter Ruling 20201003 (Issued January 29, 2020; Released May 22, 2020)**

Estate granted extension of time to make QTIP election

The first spouse died leaving all of his property in a marital trust for the benefit of the surviving spouse. The trust document provided that the marital trust property was to be treated as QTIP property for federal and state death tax purposes if the necessary election was made.

The surviving spouse, as the personal representative, retained an accountant to prepare the Form 706 (Estate Tax Return). The accountant prepared the Form 706 but failed to prepare a Schedule M to be included with the return. After the filing of the Form 706, new counsel was retained to advise the surviving spouse on her estate planning. During the review by the new counsel, the failure to file the Schedule M and make the QTIP election on the first spouse's return was discovered. As a result, the spouse requested an extension of time to make a QTIP election for the marital trust.

Treas. Reg. § 301.9100-1(c) gives IRS the discretion to grant a reasonable extension of time for a regulatory election. Under Treas. Reg. § 301.9100-3, a request for an extension of time will be granted when the taxpayer shows that the taxpayer acted reasonably and in good faith and that granting the relief will not prejudice the interests of the government. A taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional and the tax professional failed to make or advise the taxpayer to make an election.

The IRS found that the requirements of Treas. Reg. § 301.9100-3 had been satisfied and granted an extension of time for the estate to make the QTIP election for the marital trust.

GIFTS

14. **Letter Rulings 202016002 through 202016006 (Issued October 30, 2019; Released April 17, 2020)**

Service rules on matters arising from settlement of surviving spouse's challenge to decedent's will

In these five similar letter rulings, the IRS ruled on matters involving a set of trusts that entered into a settlement agreement to resolve the surviving spouse's challenge to the decedent's will. Prior to Decedent's death, Decedent and Spouse were living apart and became estranged. After Decedent's death, Bank opened Decedent's probate estate in the local probate court. Spouse filed a Petition for Revocation in the probate court challenging Decedent's will on grounds of lack of testamentary capacity and undue influence by the Bank. Subsequently, the parties filed actions in two circuit courts.

After substantial litigation, the parties entered into a Settlement Agreement. The primary purpose of the Settlement Agreement was to terminate an Irrevocable Trust created for Spouse and a Marital Trust and to preserve the trust funds to meet Decedent's intent to provide for Spouse and Charitable Trust.

The IRS granted the requested rulings regarding the following:

(1) The entire Irrevocable Trust constitutes qualified terminable interest property (QTIP) under tax code Section 2523(f), as does the entire Marital Trust (as divided into a GST Exempt Marital Trust and a GST Non-Exempt Marital Trust), under Section 2056(b)(7)(B.

(2) A "principal distribution" from the Irrevocable Trust to Spouse for maintenance and support doesn't constitute a disposition under Section 2519 (regarding treatment of dispositions as transfer of trust interests other than qualifying income interest) by Spouse;

(3) Spouse's proposed transfer of her qualifying income interests in the Irrevocable Trust, GST Exempt Marital Trust, and GST Non-Exempt Marital Trust will constitute dispositions to which Section 2519 applies and will not result in gifts by Spouse, because she will receive the present value of such interests.

(4) Spouse's transfer of her trust interests, other than qualifying income interest, to Charitable Trust will result in gift tax deductions for her under Section 2522, assuming that trust meets the description in Section 2522(a).

(6) Spouse's disclaimer of her remote contingent remainder interests in three Individual Trusts won't result in any gifts by her, because she received full and adequate consideration of those interests.

(7) The termination of the Irrevocable Trust, GST Exempt Marital Trust, and GST Non-Exempt Marital Trust will result in Spouse making a deemed gift of the entire fair market value of the assets therein, which won't be includible in her gross estate.

(8) The indirect exchange between Spouse — as a substantial contributor to Charitable Trust and as a family member of its creator — and Charitable Trust will not constitute "self-dealing" under Section 4941, because the term does not apply to a transaction between a private foundation and a disqualified person where such status arises only as a result of such transaction.

15. **T. D. 9889 -- Final Regulations on Inclusion Events for Qualified Opportunity Funds (December 19, 2019)**

IRS issues final regulations on Qualified Opportunity Funds

An Opportunity Fund is an investment vehicle, which is intended to invest in real estate in "Opportunity Zones." In turn, Opportunity Zones are specific geographic areas designated as economically distressed. Tax incentives for investments in Opportunity Zones include delayed and potentially reduced taxes on capital gains. Opportunity zones were created as part of the 2017 Tax Act through the creation of a new Sub Chapter Z, which contains two new sections, 1400Z-1 and 1400Z-2. They are intended to encourage investment in underfunded, low-income and distressed communities that are designated by the states and subsequently certified by the Secretary of the Treasury. A Qualified Opportunity Fund must invest at least ninety percent of its assets in designated opportunity zones to receive the preferential treatment.

An individual who has sold appreciated property may defer recognition of the resulting capital gain (currently through December 31, 2026) by investing the gain in a Qualified Opportunity Fund within 180 days. The basis of the individual in the Qualified Opportunity Fund is initially zero and increases by ten percent of the original deferred gain after five years, and by another five percent after seven years. Under current law, on December 31, 2026, the gain will be recognized and the investor's basis in the fund will be stepped up to the amount of the original gain that was invested in the fund. A provision of Section 1400Z-2 provides a way in which an investor can avoid the recognition of all gain and use the fair market as basis by holding the investment for ten years (which is beyond the December 31, 2026 date).

Proposed regulations were issued in May 2019 and final regulations were issued on December 19, 2019 and published in the Federal Register on January 13, 2019. These regulations will take effect beginning March 13, for taxable years beginning after March 13, 2020.

The regulations provide that the deferred gain will be accelerated because of an "inclusion event" with respect to an individual's interest in a Qualified Opportunity Fund. The final regulations provide that an event is an inclusion event if it "reduces an eligible taxpayer's direct equity interest for federal income tax purposes in the qualifying investment." Consequently, under this broad definition, the transfer during life of a qualifying investment by gift will be an inclusion event that accelerates the capital gain. On the other hand, the final regulations provide that a transfer of a qualifying investment because of the death of the individual will not be an inclusion event. Transfers by reason of death include:

1. Transfer to a deceased owner's estate as a result of a deceased owner's death;
2. A distribution of a qualifying investment by a deceased owner's estate;
3. A distribution of a qualifying investment by a deceased owner's trust as result of the death of the deceased owner;
4. The passing of a jointly-owned qualifying investment to the surviving co-owner or co-owners by operation of law; and
5. Any other transfer of a qualifying interest by operation of law upon the death of the deceased owner.

The rules on transfers at death do not apply to a sale or other disposition by a deceased owner's estate or trust or any disposition by a recipient of the qualifying investment upon the death of the deceased owner.

The inclusion event rules do not apply to contributions to grantor trusts. See Treas. Reg. § 1.1400Z2(b)-1(c)(5)(i). The exception appears to apply to all grantors including trusts treated as grantor trusts under the deemed owner rules for third parties of Section 678. The exception also applies to transfers from the grantor trust to the deemed owner, be it the actual grantor or a third party.

16. **<u>Cavallaro v. Commissioner</u>, T.C. Memo 2014-189; 842 F.3d 16 (1st Cir. 2016), aff'g in part, rev'g in part and remanding; and T.C. Memo 2019-144**

Tax Court holds that husband and wife are liable for gift tax following company merger, but reduces amount of additional gift upon remand from First Circuit Court of Appeals

In 1979, Mr. and Mrs. Cavallaro started Knight Tool Company. Knight was a contract manufacturing company that made tools and machine parts. In 1982, Mr. Cavallaro and his eldest son developed an automated liquid dispensing machine they called CAM/ALOT. Subsequently, in 1987, Mr. and Mrs. Cavallaros' three sons incorporated Camelot Systems, Inc., which was a business dedicated to the selling of the CAM/ALOT machines made by Knight. The two companies operated out of the same building, shared payroll and accounting services, and collaborated in the further development of the CAM/ALOT product line. Knight funded the operations of both companies and paid the salaries and overhead costs for both.

In 1994, Mr. and Mrs. Cavallaro sought estate planning advice from a big four accounting firm and a large law firm. The professionals advised Mr. and Mrs. Cavallaro that the value of CAM/ALOT Technology resided in Camelot (the sons' company) and not in Knight and that they should adjust their estate planning. Mr. and Mrs. Cavallaro and their three sons merged Knight and Camelot in 1995 and Camelot was the surviving entity. Part of the reason for the merger was to qualify for Conformite Europeenne, which means European conformity, so that the CAM/ALOT machines could be sold in Europe. In the 1995 merger, Mrs. Cavallaro received 20 shares, Mr. Cavallaro received 18 shares, and 54 shares were distributed to the three sons. In valuing the company, the accounting firm assumed that the premerger Camelot had owned the CAM/ALOT technology. The Tax Court found that Camelot had not owned the CAM/ALOT technology, and as a result, the Tax Court found that the appraiser overstated the relative value of Camelot and understated the relative value of Knight at the time of the merger.

In 1996, Camelot was sold for $57 million in cash with a contingent additional amount of up to $43 million in potential deferred payments based on future profits. No further payments were made after the 1996 sale. Three issues were under review by the tax court:

1. Whether the 19 percent interest received by Mr. and Mrs. Cavallaro in Camelot Systems, Inc., in exchange for their shares of Knight Tool Company in a tax free merger, was full and adequate consideration, or whether it was a gift.

2. Whether Mr. and Mrs. Cavallaro were liable for additions to tax under Section 6651(a)(1) for failure to file gift tax returns for 1995, or whether the failure was due to reasonable cause.

3. Whether there were underpayments of gift tax attributable to the gift tax valuation understatement for purposes of the accuracy related penalty, or whether any portions of the underpayment were attributable to reasonable cause.

With respect to the valuation issue, the Cavallaros offered two experts regarding the value of the combined entity. One expert valued the entity at between $70 million and $75 million and opined that only $13 million to $15 million of that value was attributable to Knight. A second appraiser valued the combined entity at $72.8 million.

The IRS retained its own appraiser, Marc Bello of Edelstein & Company. Bello assumed that Knight owned the CAM/ALOT technology. He valued the combined entities at approximately $64.5 million and found that 65 percent of that value, or $41.9 million, was Knight's portion.

In reaching its decision on the gift tax liability, the Tax Court noted that the 1995 merger transaction was notably lacking in arm's-length characteristics and Camelot may have been a sham company. It also discussed how the law firm in 1995 had tried to document the ownership of the CAM/ALOT technology by the sons but that such documentation was insufficient. The Court did not accept the testimony of the accounting firm. It noted that the IRS had conceded during the litigation that the value of the combined entities was not greater than $64.5 million and that the value of the gift made in the merger transaction was not greater than $29.6 million. As a result, the Tax Court concluded that Mr. and Mrs. Cavallaro made gifts totaling $29.6 million in 1995.

The Tax Court rejected the imposition of penalties for failure to file a gift tax return and accuracy-related penalties. It found that in both instances, Mr. and Mrs. Cavallaro had been advised by an accountant or lawyers and that there was reasonable cause for the failure to file a gift tax return and failure to pay the appropriate amount of tax. It noted that Mr. and Mrs. Cavallaro relied on the judgment and advice of the professional advisors and that the CAM/ALOT technology had been owned by the sons' company since 1987 (and thus was not being transferred in 1995). In documenting its finding of reasonable cause to avoid the penalties, the Tax Court went into great detail about Mr. and Mrs. Cavallaros lack of formal education beyond high school and that they had built the business themselves.

In their appeal, Mr. and Mrs. Cavallaros argued that the Tax Court erred in three respects:

1. Its failure to shift the burden of proof to the IRS;
2. Concluding that Knight owned the intangible assets (the CAM/ALOT technology); and
3. Misstating the Cavallaros' burden of proof and failing to consider flaws in the opinion offered by Marc Bello.

The First Circuit Court of Appeals in 2016 held that the Tax Court was correct in not shifting the burden of proof to the IRS and that Knight owned the intangibles including the CAM/ALOT technology. The First Circuit remanded the case to the Tax Court on the issue of the Tax Court's failure to accept the Cavallaros' argument that the IRS's valuation was "arbitrary and excessive" by challenging Bello's methodology. The Tax Court had refused to hear that challenge on the grounds that, even if the Cavallaros were correct, they were unable to show the correct amount of their tax liability. The First Circuit held that the Tax Court should evaluate the Cavallaros' argument that Bello's appraisal contained methodological flaws that made arbitrary and excessive.

The Tax Court on remand rejected all but one of the Cavallaros' arguments with respect to Bello's appraisal. The Tax Court first found that Bello's failure to interview the principals of Knight and Camelot and his failure to do a site visit did not cause him to misunderstand the nature of the business of each of Knight and Camelot. The Tax Court also rejected the Cavallaros' challenges of Bello's profit reallocation calculation and discounted cash flow calculation. The Tax Court did find that Bello's placement of Camelot in the 90th percentile of similar businesses was based on a statistically unreliable method and was incorrect. Instead, Camelot should have been in the 88.3d percentile and this would make a significant difference in valuation. This reduced the rounded value of the gift by $6.9 million from $29.6 million to $22.8 million.

17. **Revenue Procedure 2021-3, 2021-1 IRB 140 (January 4, 2021)**

Service states that it will not issue rulings on consequences of incomplete non-grantor trusts

In Item (17) of Section V of Revenue Procedure, 2021-3, the Internal Revenue Service stated that it would no longer issue letter rulings with respect to incomplete gift non-grantor trusts which are sometimes referred to as "INGS," "DINGS" (if set up under Delaware law), or "NINGS" (if set up under Nevada law) when it added incomplete gift non-grantor trusts to the areas that under study. Letter rulings will only be issued when the Service resolves the issue through the publication of a revenue ruling, revenue procedure, regulation, or otherwise.

Previously, in Revenue Procedure, 2020-3, 2020-1 IRB 131 (January 2, 2020), the Service stated that it will not issue letter rulings with respect to beneficiary incomplete non-grantor trusts if the proposed trusts did not follow the provisions set forth in those trusts which the Service had approved in prior letter rulings.

An ING is structured to be a non-grantor trust for income tax purposes that is funded by transfers from the grantor that are incomplete gifts for gift tax purposes. Assuming the trust is established in a state that doesn't tax the income accumulated in the trust (such as Delaware or Nevada), the trust will avoid state income taxes as long as the state of residence of the grantor or beneficiaries doesn't subject the trust's income (or accumulated income) to tax. Moreover, if structured and administered properly, the trust property should be protected from the grantor's creditors.

The ING allows a grantor to achieve both of these benefits while still being able to receive discretionary distributions of trust property and without paying gift tax (or using any gift tax exemption) on the transfer of property to the trust. A gift from the grantor will be complete upon a subsequent distribution from the trust to a beneficiary other than the grantor, and whatever property remains in the trust will be subject to estate tax at the grantor's death.

An ING is particularly attractive for a highly appreciated asset in anticipation of sale of that asset. For example, the founder of a business that is going to be sold may face hundreds of thousands or even hundreds of millions of dollars of capital gain because he or she has so little basis. Avoiding state income tax on those gains can be a significant benefit.

Letter Ruling 202017018 (issued November 29, 2019; released April 24, 2020) is a recent example of many letter rulings with similar facts on the tax consequences of an incomplete non-grantor trust. Previous rulings on this subject include Letter Ruling 201836006 (issued May 30, 2018; released September 2018) and Letter Ruling 202014001 (issued August 26, 2019; released April 3, 2020).

In Letter Ruling 202017018, grantor created an irrevocable trust. The beneficiaries were grantor, grantor's spouse, grantor's issue, grantor's parents, and other issue or grantor's parents. A corporate trustee was the sole trustee of the trust.

The trust created a distribution committee. The distribution committee was initially composed of the grantor, grantor's spouse, grantors parents, and grantor's sister. Until the death of the grantor, the distribution committee was to have at least two members, other than grantor or grantor's spouse.

Under the terms of trust, the trustee was to distribute income and principal of the trust as directed by the distribution committee, grantor, or both as follows:

1. Grantor's Consent Power. Income or principal to any beneficiary other than the grantor's spouse as determined by a majority of the distribution committee, other than grantor or grantor's spouse, acting in a non-fiduciary capacity with the written consent of grantor.

2. Unanimous Committee Power. Income or principal to any beneficiary as determined by the unanimous decision of the distribution committee, other than grantor or grantor's spouse, acting in a non-fiduciary capacity.

3. Grantor' Sole Power. Principal to any beneficiary other than grantor or grantor's spouse as determined by grantor acting in a non-fiduciary capacity for the support, health, or education of a beneficiary.

Grantor held a testamentary power of appointment to the issue of grantor's parents (other than the grantor, his estate, or the creditors of either); grantor's spouse, or one or more charitable organizations. The balance not effectively appointed by grantor upon his death would be distributed to a designated trust.

The taxpayer sought the following rulings:

1. During the period that the distribution committee was serving, there would be no income tax consequences to the grantor or any member of the distribution committee under the grantor trust rules.

2. The grantor's contribution of property of the trust was not a completed gift subject to federal gift tax.

3. Any distribution of property from the trust by the distribution committee to the grantor was not a completed gift for gift tax purposes by a member of the distribution committee to the grantor.

4. Any distribution of property by the distribution committee from the trust to any beneficiary of the trust other than the grantor was not a completed gift for gift tax purposes by any member of the distribution committee to that beneficiary.

5. No member of the distribution committee would be deemed to have a taxable general power of appointment pursuant to Section 2041 or Section 2514 upon his or her death.

The Service first ruled that none of the provisions of the trust would cause the grantor to be treated as the owner of the trust for income tax purposes under any of Sections 673, 674, 676, 677, 678, or 679 as long as the distribution committee remained in existence and was serving and the trust was a domestic trust.

The Service stated that examination of the trust revealed none of the circumstances that would cause administrative controls to be considered exercisable primarily for the benefit of the grantor under Section 675. A determination of whether Section 675 would cause the grantor to be treated as the owner of any portion of the trust for income tax purposes was deferred until the federal income tax returns of the trust were examined.

The Service next ruled that a contribution of property to the trust was not a completed gift by the grantor for gift tax purposes. Any distribution from the trust to the grantor was merely a return of grantor's property. Upon grantor's death, the fair market value of the property in the trust was subject to estate tax in the grantor's gross estate.

The Service lastly ruled that any distribution of property by the distribution committee to a beneficiary of the trust, other than the grantor, would not be a gift subject to gift tax by any member of the distribution committee. Instead, any such distribution would be a completed gift by the grantor. In addition, the powers held by the distribution committee were not general powers of appointment under Section 2041 and, accordingly, no property held in the trust would be included in the gross estate of any member of the distribution committee upon his or her death under Section 2041.

18. James C. Nelson v. Commissioner, T.C. Memo 2020-81

Tax Court finds that formula for gift, sale of limited partnership interests at a discount is not a defined value formula, and additional gift tax is imposed

This case was consolidated with the case of Mary P. Nelson v. Commissioner. Husband and Wife, James and Mary Nelson, formed Longspar Partners, Ltd. as a Texas limited partnership on October 1, 2008. The stated purposes for creating Longspar Partners were:

(1) to consolidate and protect assets;

(2) to establish a mechanism to make gifts without fractionalizing the interest; and

(3) to ensure that the underlying entity, Warren Equipment Company ("WEC"), remained in business and under the control of the Warren family.

WEC, in turn controlled several businesses established by Mrs. Nelson's father in construction equipment and oil-related businesses. Mrs. Nelson and custodial accounts and trusts for descendants contributed 65,837 WEC shares (approximately 27 percent of the WEC common stock) to Longspar Partners in addition to some other assets. Mrs. Nelson's siblings and others held the remaining WEC shares.

After the creation of Longspar Partners, Mr. and Mrs. Nelson each held ½ of the one percent general partner interest. Mrs. Nelson held 93.88 percent of the limited interests. The remaining interests were held in the custodial accounts or trusts for descendants.

On December 23, 2008, Mr. and Mrs. Nelson created the Nelson 2008 Descendants Trust of which Mrs. Nelson was the settlor and Mr. Nelson was the trustee of the trust as well as being a beneficiary with the couple's four daughters. On December 31, 2008, Mrs. Nelson gifted Longspar limited partnership interests to the trust. The Memorandum of Gift stated:

> [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.

Subsequently, on January 2, 2009, Mrs. Nelson sold Longspar limited partnership interests to the 2008 Descendants Trust. The Memorandum of Sale provided that she was transferring limited partnership interests having a fair market value of $20,000,000 as of January 2, 2009 as determined by a qualified appraiser within 180 days of the effective date of the assignment. Neither the Memorandum of Gift nor the Memorandum of Sale contained 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 $20,000,000 as consideration for the Longspar limited partnership interests purchased by the 2008 Descendants Trust.

Subsequently, Mr. and Mrs. Nelson retained a qualified appraiser to value the Longspar limited partnership interests in connection with both the 2008 gift and the 2009 sale. The appraiser concluded that as of the dates of the gift and the sale, the value of a one percent limited partnership interest in Longspar was $341,000. As a result, the appraiser calculated that Mrs. Nelson gave 6.14 percent of her Longspar limited partnership interests (value of $2,093,740) to the trust on December 31, 2008 and sold 58.65 percent of her Longspar limited partnership interests (value of $19,999,650) on January 2, 2009. Thus, a total of 64.79 percent of Mrs. Nelson's Longspar limited partnership interests were given or sold to the 2008 Descendants Trust.

Subsequently, the Internal Revenue Service reviewed Mr. and Mrs. Nelson's 2008 and 2009 gift tax returns. On the 2008 gift tax returns, each reported a gift to the trust and classified it as a split gift so that each was responsible for half the gift. The couple did not report the January 2, 2009 sale of the limited partnership interests on the 2009 gift tax returns since it was a sale.

Subsequently, the IRS on audit determined that the 2008 gift was undervalued and that there was a gift tax deficiency of $611,708 for the 2008 gift. Likewise, the IRS imposed a gift tax deficiency of $6,123,168 for the 2009 because of the undervaluation of the Longspar partnership interests. The IRS also imposed accuracy related penalties under Section 6662(a) but conceded these penalties on audit.

On the basis of settlement discussions with IRS Appeals, Mr. and Mrs. Nelson amended Longspar's partnership agreement to record the 2008 Descendants Trust's interest as 38.55 percent rather than 64.79 percent.

The issues for the court were whether Mr. and Mrs. Nelson had used a defined value formula in which case there would be no adverse gift tax consequences and if they had not, what was the value of the interest that was transferred.

Mr. and Mrs. Nelson argued that the transfer documents showed that Mrs. Nelson transferred specific dollar amounts of Longspar limited partnership interests and not fixed percentages citing Wandry v. Commissioner, T.C. Memo 2012-88; Hendrix v. Commissioner, T.C. Memo 2011-133; Estate of Petter v. Commissioner, T.C. Memo 2009-280; and McCord v. Commissioner, 461 F.3d 614 (5th Cir. 2006). The court disagreed. It noted that the interests transferred in this case were expressed as an interest having a fair market value of a specific dollar amount as determined by an appraiser within a fixed period. As a result, the value depended on the determination by an appraiser within that fixed period. The definition of value was not further qualified, for example, as that determined for federal estate tax purposes. Such a further qualification was found in Estate of Christensen v. Commissioner, 130 T.C. 1 (2008) aff'd. 586 F.3d 1061 (8th Cir. 2009). The clause in that case stated that fair market value would be "as such value is finally determined for federal estate tax purposes." Similarly, in Petter, the clause referenced the amount that can pass free of federal gift tax as finally determined for federal gift tax purposes. As a result, the court concluded that Mrs. Nelson transferred a 6.14 percent limited partnership interest by gift and a 58.35 percent limited a qualified appraiser determined partnership interest in Longspar by sale to the trust and these percentages within a fixed period.

The court then, in a lengthy discussion of valuation, first had to decide what discount should be applied to the WEC common stock held in Longspar Partners. The estate's appraiser had valued the WEC common stock at $860 per share while the IRS's appraiser valued the WEC common stock at $1,072 per share. The court determined that a 15 percent discount for lack of control and a 30 percent discount for lack of marketability should apply. This resulted in a fair market value of $912 per share. The court then applied a discount of 5 percent for lack of control and 28 percent discount for lack of marketability to calculate the fair market value of a Longspar limited partnership interest and determined that the value of a Longspar limited partnership interest was $411,235. As a result, Mrs. Nelson made a gift of Longspar limited partnership interests having a value of $2,524,983 in 2008 ($428,983 more than reported on the 2008 gift tax return) and sold Longspar limited partnership interests having a value of $24,118,933 resulting in a gift in 2009 of $4,118,933.

19. **Grieve v. Commissioner, T.C. Memo 2020-28**

Court accepts donor's valuation for nonvoting LLC interests transferred to grantor retained annuity trust and irrevocable gift trust

Pierson Grieve was a successful businessman who ended his career as the Chairman and Chief Executive Officer of EcoLab, Inc., a publicly traded corporation. Pierson engaged in estate planning starting in the late 1980's or the early 1990's, which included the creation of a family limited partnership of which Pierson M. Grieve Management Corp. (PMG) was the General Partner. Pierson consolidated the management of his assets in PMG.

In 2008, Pierson's daughter, Margaret, purchased PMG and became its sole owner and president. In 2012, Pierson and his wife, Florence, engaged a law firm to review and update their estate plan. Florence died in 2012 before the finalization of the updated estate plan.

Margaret worked with the law firm to develop and implement the updated estate plan. In 2012, Pierson created an irrevocable trust for the benefit of his children with South Dakota Trust Company as trustee (2012 Irrevocable Trust).

Part of the update of the estate plan also included the creation of two limited liability companies. Florence and PMG formed Angus LLC in August 2012. PMG had all Class A voting units representing 0.2 percent of Angus and Florence had all Class B nonvoting units representing 99.8 percent of Angus. The assets of Angus included a brokerage account with cash and short-term investments, limited partnership interests, investments in venture capital funds, and promissory notes. The value of the assets in Angus on the date of its creation was $31,970,683. Florence transferred all her Angus interests to Pierson approximately one month after the creation of Angus.

Pierson's revocable trust, of which Margaret was the trustee, and PMG formed Rabbit LLC in July 2013. PMG had all Class A voting units representing 0.2 percent of Rabbit and Pierson's revocable trust held all nonvoting Class B units representing 99.8 percent of Rabbit. The two major assets of Rabbit were 82,984 EcoLab shares and $1,000,000 in cash. The value of the Rabbit assets on October 9, 2013 was $9,102,757

On October 6, 2013, Pierson and Margaret, as trustee of Pierson's revocable trust, created a zero-out Grantor Retained Annuity Trust (GRAT) that provided for the payment of an increasing annuity over two years. The first annuity payment was equal to 47.14757 percent of the fair market value of the assets contributed and the second annuity payment was equal to 56.57708 percent of the fair market value of the assets contributed. The GRAT was funded with all 9,980 Class B nonvoting units of Rabbit. Pierson valued the Class B Rabbit nonvoting units at $5,903,769 as of the date of the gift. This represented a 13.4 percent lack of control discount and a 25 percent lack of marketability discount which, when combined, produced a 35.0 percent discount. Valuation Consulting Group prepared the valuations for the gift tax return.

On November 1, 2013, Pierson, individually, and South Dakota Trust Company, as trustee of the irrevocable gift trust, entered into a single life private annuity agreement. Pierson assigned all of his 9,980 Class B nonvoting Angus interests to the 2012 Irrevocable Trust in exchange for annual annuity payments of $1,420,000. The private annuity had a fair market value of $8,043,675. Pierson intended to make a net taxable gift to the extent that the fair market value of the Class B nonvoting Angus interests exceeded the value of the annuity. Pierson valued the Class B Angus nonvoting interests at $20,890,934 for gift tax purposes. This represented a 12.7 percent lack of control discount and a 25 percent lack of marketability discount which, when combined, produced a 34.5 percent discount. The value of the net gift was $9,966,659.

On January 29, 2018, the IRS issued a Notice of Deficiency which increased the value of the 9,980 Class B Rabbit nonvoting units transferred to the GRAT from $5,903,769 to $9,048,866 (a 0.4 percent discount). The IRS increased the value of the 9,980 Class B nonvoting Angus units transferred to the 2012 Irrevocable Trust from $20,890,934 to $31,884,403 (a 0.1 percent discount). This increased the value of the net gift from $9,966,659 to $17,819,139.

The Tax Court stated that the hypothetical willing buyer-willing seller test applies to the valuation of the transferred Rabbit and Angus units. Pierson submitted valuations of Rabbit and Angus prepared by Will Frazier to the court. Using a combination of the market approach and the income approach, Frazier concluded that the Class B nonvoting Rabbit interests transferred to the GRAT on a noncontrolling nonmarketable basis were worth $5,884,000 (a 35.0 percent discount). Frazier also concluded that the Class B nonvoting Angus interests transferred to the 2012 Irrevocable Trust on a noncontrolling nonmarketable basis were worth $19,854,000 (a 37.8 percent discount).

The IRS's appraiser, Mark Mitchell, took a different approach. Mitchell concluded that any willing seller of the Class B nonvoting units in Rabbit and Angus would look to acquire the 0.2 percent Class A voting units in each held by PMG to avoid the large discounts that a willing buyer would seek. Mitchell concluded that a hypothetical seller would pay PMG a premium or its 0.2 percent Class A voting units in Rabbit and Angus. Mitchell valued the Rabbit Class B nonvoting units at $8,918,940 (a 1.4 percent discount) and the Angus Class B nonvoting units at $31,456,742 (a 1.4 percent discount).

The court rejected Mitchell's approach. Citing <u>Estate of Giustina v. Commissioner</u>, 586 F. App'x 417 (9th Cir. 417), rev'g and remanding T.C. Memo 2011-14, the court stated that the value at the date of the gift shall be the amount of the gift. The court would "not engage in imaginary scenarios as to who a purchaser might be." The court then cited the statement in <u>Olson v. United States</u>, 292 U.S. 246 (1934), that

> Elements affecting value that depend upon events or combinations of occurrences which, while within the realm of possibility, are not fairly shown to 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."

The court noted that the daughter, Margaret, the sole owner of the Class A voting units, testified that she had no intention of selling the units, and that if she ever sold the units, she would demand a premium higher than Mitchell's estimated value.

The court found that that the facts did not show the reasonable probability of a willing seller or a willing buyer of the Class B nonvoting units also buying the Class A voting units or that the Class A units would be available for purchase. Instead, the examination should be limited to only the willing buyer and the willing seller of the Class B nonvoting units.

In rejecting Mitchell's valuations of the Class B nonvoting units, the court stated that Mitchell's reports lacked the empirical data to back up his calculation of the 5 percent premium to purchase the Class A voting units, evidence to show that his methodology was subject to peer review, and citations to case authority in support of his methodology.

The court then accepted Frazier's valuation, noting that Frazier had combined the market approach and the income approach in valuing the Class B nonvoting interests.

One interesting fact is that any increase in the value of the Rabbit Class B nonvoting interests would have produced no additional gift or gift tax since that GRAT was a zero-out GRAT. Instead, the amount of the two annuities would have increased because of the adjustment clause in GRAT instrument adjusting the annuity if the value of the assets was adjusted.

20. <u>Estate of Mary P. Bolles v. Commissioner</u>, T.C. Memo 2020-71

Advances made by decedent to son lost characterization as loans and became gifts of inheritance advances when decedent realized loans would not be repaid

Mary Bolles died on November 19, 2010. While Mary was alive, she made large advances to her son, Peter, for more than twenty years to support him in his architectural business Upon Mary's death, the Internal Revenue Service took alternative positions in auditing the estate tax return. The first was that a promissory note of $1,063,333 issued by Peter in favor of Mary plus interest of $1,165,778 should have been included as an asset of the estate. Alternatively, the IRS argued that Mary made adjustable taxable gifts to Peter of $1,063,333 that should be included in computing the estate tax liability. In the litigation, the IRS conceded its first position leaving whether Mary's advances to Peter were gifts or loans as the only issue.

The court looked at <u>Miller v. Commissioner</u>, 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. These factors include:

1. the existence of a promissory note or other evidence of indebtedness;
2. the charging of interest;
3. the use of security or collateral;
4. the present of a fixed maturity date;
5. the making of a demand for repayment;
6. any actual repayment;
7. the ability of the transferee to repay;
8. any records maintained by either the transferor or the transferee that reflect the transaction as a loan; and
9. the manner in which the transaction was reported for tax purposes.

The court also noted that in the case of a family loan, a long-standing principle is that an actual expectation of repayment and an intent to enforce the debt are critical to sustaining the characterization as a loan.

The court then noted that there were no loan agreements or attempts to enforce repayment even though Mary recorded the advancements as loans to Peter and kept track of the interest. The court also noted that Mary initially expected Peter to make a success of his architecture practice as his father (a successful architect) had. Mary lost that expectation slowly.

In reviewing the facts, the court then found that Peter was unlikely to repay any loans by October 27, 1989 when Mary amended her trust to block Peter from receiving any assets when she died. The block was lifted in 1995, when her trust was amended to treat the loans to Peter as advancements against his share. Accordingly, the loans lost that characterization for tax purposes in 1989. Consequently, the advances to Peter were loans through 1989 and after that were gifts. The court considered whether Mary had forgiven any of the prior loans in 1989 and found that Mary did not forgive the loans. Instead she accepted that the loans could not be repaid because of Peter's financial distress at that time.

21. **<u>Burt Kroner v. Commissioner</u>, T.C. Memo 2020-73**

Transfers from business associate were not gifts excludable from income under Code Section 102

During the tax years 2005, 2006, and 2007, Burt Kroner received wire transfers from a business associate, David Haring, who was a foreign citizen, or entities associated with Haring, totaling $4,425,000, $15,350,000, and $5,000,000, respectively. Kroner's lawyer, who was also Haring's lawyer, advised that the transfers were excludable from income under Section 102 which states that gross income does not include the value of property acquired by gift, bequest, devise or inheritance. The lawyer also advised Kroner of the requirement to file the Form 3520, Annual Return to Report Transaction with Foreign Trusts and Receipt of Certain Foreign Gifts, for each year that Kroner received a transfer from Haring into an account in his name. The Internal Revenue Service argued that the transfers were not gifts and subject to income tax under Section 102(a) and imposed a penalty for substantial understatement under Section 6662(a).

The Tax Court, noting that the intention with which Haring made the transfers was the most critical factor in determining whether the transfers were gifts, found Kroner's gifts story unconvincing and the testimony provided by Kroner and his lawyer to be unreliable. None of the testimony was supported by credible documented evidence. The lawyer represented both Kroner and Haring and was thus an interested party, and Haring, a foreign citizen, did not testify. As a result, Kroner was unable to prove that the transfers were made with disinterested generosity which is the basic requirement for a transfer to be treated as a gift. The court also noted the lawyer was evasive in his answer and in his selective invocation of the attorney-client privilege with respect to the legal advice provided to Haring about the transfers. Instead, the timing of the transfers, especially with respect to liquidity events in investments in which Kroner could not invest because of non-compete agreement, showed that Haring acted as the nominee for Kroner in those investments. The court could not find facts that showed that Haring and Kroner had the type of relationship from which there would be disinterested generosity and that would result in the substantial "gifts" which were made. Instead, Kroner and Haring had only a business relationship. As a result, the transfers were subject to income tax.

The court did not uphold the imposition of accuracy-related penalties for substantial understatement pursuant to Section 6662(a). The court found that the IRS failed to comply with the written supervisory approval requirement of Section 6751(b) when the Letter 915 which was the first letter to Kroner proposing accuracy-related penalties and providing an opportunity to file a protest with the Appeals Office was made before the Civil Penalty Approval form was signed.

ESTATE INCLUSION

22. **Badgley v. United States, _____ F.3d _____ (9th Cir. 2020)**

Assets of GRAT are included in settlor's estate when settlor dies before end of annuity term

The Ninth Circuit affirmed the district court's granting of summary judgment to the Internal Revenue Service in a matter involving the inclusion of the assets of grantor retained annuity trust ("GRAT") in the settlor's estate when the settlor dies before the end of the annuity term. See Badgley v. United States, ____ F.Supp.3d _____ (N.D. Cal. 2018).

On February 1, 1998, Patricia Yoeder created a grantor retained annuity trust. Patricia was to receive annual annuity payments for the lesser of fifteen years or her prior death in the amount of 12.5 percent of the date of gift value of the property transferred to the GRAT. The GRAT paid Patricia an annuity of $302,259. Upon the end of the annuity term, the property was to pass to Patricia's two living daughters. The GRAT also stated that, if the trustor failed to survive the trust term, the trustee was to pay all the remaining annuity amounts and the portion of the trust included in the trustor's estate to the survivor's trust created under Patricia's revocable trust.

Patricia died on November 2, 2012 having received her last annuity payment from the GRAT on September 30, 2012, two months before the expiration of the annuity term. Her daughter, Judith Badgley was the executor of Patricia's estate.

The federal estate tax return reported a gross estate of $36,829,057, including the value of the assets held in the GRAT. The estate paid federal estate taxes of $11,187,457. On May 16, 2016 the estate filed a claim of refund seeking $3,810,004 in estate tax overpaid by the estate as a result of the inclusion of the full value of the GRAT. The estate at the district court had moved for summary judgment on two bases, asserting that Section 2036(a)(1) did not apply to Patricia's GRAT and that Treas. Reg. § 20.2036-1(c)(2) was overly broad and invalid to the extent that it applied to the GRAT and that the transfer of property to the GRAT was a bona fide sale for full and adequate consideration and Section 2036 did not apply to cause inclusion of the property in the GRAT in the estate. The government moved for summary judgment on the opposite grounds.

The Ninth Circuit started it opinion by noting that "thanks to Benjamin Franklin, death and taxes are inextricably linked in most American minds as the only two things in the world that are certain." It then explained that Section 2036(a) was the response of Congress to the attempts of taxpayers to avoid the estate tax by using a variety of legal mechanisms to transfer property during their lifetimes while holding onto the fruits of that property. The presence of one or more of three strings -- possession, enjoyment, or the right to income – would cause estate inclusion. The issue for the Ninth Circuit was whether Patricia's annuity interest in the GRAT was a sufficient string to cause the inclusion of the GRAT in Patricia's estate.

The Ninth Circuit first addressed the estate's argument that because Section 2036(a)(1) does not contain the term "annuity," that section does not unambiguously apply to annuities. The Ninth Circuit disagreed. Congress instead instructed courts to look at the results – possession, enjoyment, or the right to income – rather than the form those strings took. Citing Commissioner v. Church's Estate, 335 U.S. 632 (1939), the Ninth Circuit rejected the estate's argument that because Section 2036(a)(1) does not mention annuities, the full value of Patricia's annuity could not be included in Patricia's estate.

The Ninth Circuit then moved to main issue of whether the annuity flowing from a GRAT fell within the class of will substitutes to which Section 2036(a)(1) applies. The estate argued that a "fixed-term annuity" was not the same as a right to income or some other form of possession or enjoyment as required by Section 2036(a)(1). The Ninth Circuit concluded that deriving a substantial economic benefit from property is sufficient for the application of Section 2036(a)(1). In turn, Patricia's annuity from the GRAT was a substantial economic benefit.

The Ninth Circuit that rejected the estate's attempt to say that the Supreme Court disavowed a "substance over form" argument in United States v. Byrum, 408 U.S. (1972), by noting that Byrum stated that enjoyment connoted a substantial economic benefit. Moreover, its interpretation of Section 2036(a)(1) was within the meaning of the text of that section. The Ninth Circuit then quotes various commentators with respect to the manner in which GRATs work including John Bergner that "there is no solution to the problem of dying earlier than expected," 44 U. Miami L. Ctr. On Est Plan. ¶ 401.1 (2019) and Howard Zaritsky that the grantor of a GRAT makes the decision that the potential benefits outweigh the risks. *Tax Planning for Family Wealth Transfers During Life: Analysis with Forms,* ¶ 12.06(1) (5th ed. 2013 & Supp. 2020).

Badgley also challenged Treas. Reg. 20.2036-1(c)(2) which requires that transferred GRAT property be included in a decedent's gross estate where the decedent retains an annuity interest and dies before the expiration of the annuity term and provides the formula for the calculation of the property includable under Section 2036(a). The Ninth Circuit noted that the argument on this issue was limited to two sentences and two footnotes. The cursory manner in which the argument was made waived the argument under the Federal Rules of Appellate Procedure 28(a)(8)(A). Even if the argument was not waive, it would not apply. Instead of showing how the formula was flawed or contesting the application of the formula to the annuity, Badgley merely contended that formula might be arbitrary if it was applied to a short-term GRAT which was not the case here.

As a result, Patricia's GRAT was properly included in calculating the value of her gross estate.

23. **Estate of Clara M. Morrissette v. Commissioner, Tax Court Order, Docket No. 4415-14 (June 21, 2018)**

Court denies partial summary judgment motion of estate that Section 2703 does not apply to split-dollar arrangement

Split-dollar is a method of financing the purchase of insurance. It most typically takes the form of an arrangement between a closely held business and an owner-employee, or between a public corporation and its executives, in which the employer and employee agree to split the payment of premiums on an insurance policy on the life of the insured. In 2001, the IRS announced its intent in Notice 2001-10, 2001-1 C.B. 459, to change its tax treatment of split-dollar arrangements. Thereafter, it issued new regulations, in final form, on September 17, 2003. The new taxation scheme created under these regulations significantly altered the way in which split-dollar arrangements were used for estate planning purposes thereafter.

Under the regulatory scheme put in place in 2003, two mutually exclusive methods for taxing split-dollar life insurance arrangements now apply, the economic benefit regime and the loan regime. If the employer is the owner of the insurance policy, the split-dollar arrangement will be taxed as compensation related agreement under the economic benefit regime. The value of the current life insurance protection and any other benefits derived by the insured employee from the arrangement will be treated as taxable income to the employee under Section 61 of the Internal Revenue Code. The economic benefit rules apply to both arrangements where the policy is actually owned by the employer (endorsement method split-dollar arrangements) and to arrangements in which the employee owns the policy (collateral assignment split-dollar arrangements) but the employee's only right is to the insurance protection. In this latter situation, the employer will be deemed to own the policy. Treas. Reg. § 1.61-2(c)(1)(ii)(A)(2).

Any split-dollar arrangement not described above in which the employee owns the policy will be governed under the loan regime by the Section 7872 below market loan rules. Transfers by the employer will be treated as loans and there will be deemed interest to the extent that the arrangement does not mandate adequate interest. The deemed interest will treated as compensation paid by the employer to the employee and then repaid as interest by the employee. The same rules will apply to split-dollar arrangements in all other contexts, such as shareholder-company and private donor-donee arrangements.

<u>Morrissette</u> involved a motion for partial summary judgment in a private donor-donee arrangement. The unique feature here is that the insureds were much younger than the donor. In <u>Morrissette</u>, Clara Morrisette established a revocable trust in 1994 to which she contributed all of her shares in Interstate Group Holdings which, in turn, held eleven moving and other companies. In September 2006, when Clara Morrissette was 93, her three sons became trustees of the revocable trust. Previously, on August 18, 2006, an employee of Interstate Group Holdings was appointed as a temporary conservator of Clara Morrisette's estate through October 20, 2006. The conservator transferred additional assets into the revocable trust. In addition, the conservator established three perpetual dynasty trusts in 2006, one for each of her three sons and his family. The revocable trust was amended on September 19, 2006 to permit the trustees to pay premiums on life insurance and to make loans and to enter into split-dollar arrangements.

Next, on September 21, 2006, the dynasty trusts, the three brothers, the revocable trust, and other trusts holding interests in Interstate Group Holdings entered into a shareholders agreement providing that upon the death of each brother, the surviving brothers, and the dynasty trusts would purchase the Interstate Group Holdings stock held by or for the benefit of the deceased brother. To provide each dynasty trust with the funds to purchase the Interstate Group Holdings stock held by a deceased sibling, each dynasty trust on October 4, 2006 purchased a universal life policy on the life of each of the two other brothers.

Clara Morrissette's revocable trust on October 31, 2006 entered into two split-dollar life insurance arrangements with the three dynasty trusts and then contributed $29.9 million in total to the three dynasty trusts in order to fund the purchase of the universal life insurance policies on each of Clara Morrissette's three sons. The split-dollar life insurance arrangements provided that the revocable trust would receive the greater of the cash surrender value of the respective policy or the aggregate premium payments on that policy upon termination of the split-dollar life insurance arrangement or the death of the insured brother. The right to receive a portion of the death benefit would thus be a receivable of the revocable trust.

Each split-dollar agreement provided that the agreement would be taxed under the economic benefit regime and that the only economic benefit provided to each dynasty trust was the current life insurance protection. The dynasty trusts executed collateral assignments of the policies to the revocable trust to secure the payment of the amounts owed to the revocable trust. Neither the dynasty trusts nor the revocable trust retained the right to borrow against the policies.

In each of 2006 through 2009, Clara Morrissette reported gifts to the dynasty trusts under the economic benefit regime of the cost of the current life insurance protection determined under Table 2001 less the amount of the premiums paid by the dynasty trusts. Clara Morrissette died on September 25, 2009 and was survived by her three sons. After Mrs. Morrissette's death, the estate retained Valuation Services, Inc. to value the receivables included in the gross estate as of the date of her death. Valuation Services, Inc. valued the receivables at $7,479,000.

The IRS in the audit of Clara Morrissette's estate determined that the $29.9 million contribution was a gift in 2006 and assessed a gift tax deficiency against Clara Morrissette's estate of $13,800,179 and a penalty of $2,760,036. The estate moved for partial summary judgment on the narrow issue of whether the split-dollar insurance arrangements were governed by the economic benefit regime under Treas. Reg. § 1.61-22.

In <u>Estate of Clara M. Morrissette</u>, 176. T.C. No. 11 (April 13, 2016), the Tax Court first noted that the 2003 final regulations governed the split-dollar arrangements since they were entered into after September 17, 2003. The court also noted that generally the person named is the owner in the insurance contract is treated as the owner of the contract. Under this general rule, the dynasty trusts would be considered the owners of the policies and the loan regime would apply. However, the final regulations included the special ownership rule that provided that, if the only economic benefit provided under the split-dollar life insurance arrangement to the donee is the current life insurance protection, then the donor will be deemed the owner of the life insurance contract, irrespective of actual policy ownership, and the economic benefit regime will apply.

To the court, the key question was whether the lump sum payment of premiums made directly made by the revocable trust on the policies in 2006 generated any additional economic benefit other than the life insurance protection to the dynasty trusts. If there was no additional economic benefit to the dynasty trusts, then the revocable trust would be deemed the owner of the policies by way of the special ownership rule and the split-dollar life insurance arrangements would be governed by the economic benefit regime. To determine whether any additional economic benefit was conferred, the relevant inquiry was whether the dynasty trusts had current access to the cash values of the respective policies under the split-dollar life insurance arrangement or whether any other economic benefit was provided. The court determined that the dynasty trusts did not have access to any part of the cash value of the insurance policies or to any other economic benefit except for the current life insurance protection. As a result, the economic benefit regime and not the loan regime applied.

The important issue yet to be determined with respect to Morrissette is the value of the receivables in Clara Morrissette's estate for estate tax purposes and whether the receivables should only be valued at approximately $7,500,000. The resolution of this issue will determine the usefulness for estate and gift tax purposes of the split-dollar financing of the policies in this particular situation.

On December 5, 2016, the estate moved for partial summary judgment that Section 2703 does not apply for purposes of the valuation of Clara Morrissette property rights under the split-dollar arrangements estate tax. Section 2703(a) provides that for transfer tax purposes with respect to buy-sell and similar arrangements between family members, the value of properties are determined without regard to (1) any option, agreement, or other right to acquire or use property at less than fair market value, or (2) any restriction on the right to sell or use the property.

As noted above, the decedent entered into split-dollar arrangements through her revocable trust with the three dynasty trusts that had been established in the name of each of her three sons. The court held that the economic benefit regime applied and the cost of the current insurance protection was a transfer each year from the decedent to the son for gift tax purposes. The parties agreed that for estate tax purposes the estate must include the decedent's rights under the split dollar arrangements in the gross estate. The parties disagreed over exactly what rights the decedent had over the split-dollar arrangements and whether those rights were subject to any restrictions pursuant to Section 2703(a)(2). The estate argued that the decedent's only right under the split-dollar arrangement was the death benefit and that right was without restriction. The government argued that the decedent's right also included the right to terminate the split-dollar agreements with the consent of the other party at any time and to receive a payout upon termination. It argued that the termination rights were restricted by the split-dollar arrangements and that Section 2703(a)(2) applied to disregard the termination restrictions. The IRS also argued that decedent had rights under the collateral assignment agreements and that those restrictions should be disregarded. As a result, summary judgment should be denied because there was a genuine issue of material fact.

Pursuant to Estate of Cahill v. Commissioner, T.C. Memo 2018-84, a restriction on a decedent's termination rights is a restriction for purposes of Section 2703. In Estate of Cahill, the Tax Court denied the estate's motion for partial summary judgment that Section 2703(a) did not apply to split-dollar arrangements with termination restrictions similar to those at issue in Morrissette where the parties to the agreements can mutually agree to terminate the arrangement but neither party could unilaterally terminate the arrangements. Here the decedent's trust and the respective dynasty trusts could mutually agree to terminate the split-dollar arrangement but neither party could unilaterally terminate the agreement.

As a result, Judge Goeke denied the motion for partial summary judgment.

24. **__Cahill v. Commissioner__, T.C. Memo 2018-84; settled, Joint Stipulation of Settled Issues, Tax Court Docket 10451-16 (August 16, 2018)**

Taxpayer's motion for summary judgment with respect to split-dollar arrangement is denied

Richard F. Cahill died on December 12, 2011. His son, Patrick Cahill, was named as executor. This case involves three split-dollar agreements that were executed in 2010 when Richard was 90 years old and unable to manage his own affairs.

Richard was the settlor of a revocable trust called the Survivor Trust. Patrick was the trustee of the Survivor Trust and was also decedent's attorney-in-fact under a California Power of Attorney. Richard's involvement in the three split dollar life insurance arrangements was effected solely through the Survivor Trust and was directed by Patrick Cahill either as decedent's attorney in fact or as trustee of Survivor Trust. The parties agreed that everything in the Survivor Trust on decedent's date of death was included in the decedent's gross estate. Decedent was also settlor of the Morrison Brown ("MB") Trust which was created in September 2010 by Patrick Cahill as decedent's agent. William Cahill was trustee of the MB Trust and the primary beneficiaries of the MB Trust were Patrick and his issue. The MB Trust owned three whole life insurance policies. Two policies were on the life of Shannon Cahill, Patrick Cahill's wife, and one policy was on the life of Patrick Cahill. The policy premiums were paid in lump sums as shown in the chart below.

	Policy Premium	Policy Amount
New York Life on Patrick Cahill	$5,580,000	$40,000,000
SunLife on Shannon Cahill	$2,531,570	$25,000,000
New York Life on Shannon Cahill	$1,888,430	$14,800,000
TOTAL	**$10,000,000**	**$79,800,000**

To fund these policies, three separate split-dollar agreements were executed by Patrick Cahill, as the trustee of the Survivor Trust, and William Cahill as trustee of the MB Trust. The Survivor Trust paid the premiums using funds from a $10 million loan from Northern Trust. The obligors on the loan were the decedent personally and Patrick Cahill as trustee of the Survivor Trust. Each split dollar arrangement was designed to take advantage of the economic benefit regime and avoid the loan regime. Upon the death of the insured, the Survivor Trust was to receive a portion of the death benefit equal to the greatest of the remaining balance on the loan, the total premiums paid with respect to the policy, or the cash surrender value. The MB Trust would retain any excess.

Each split-dollar agreement also provided that it could be terminated during the insured's life by written agreement between the trustees of the Survivor Trust and the MB Trust. As of the date of Richard's date in 2011, the aggregate cash surrender value of the policies was $9,611,624. The estate's tax return reported the total value of decedent's interest in the split-dollar agreements at $183,700. In the Notice of Deficiency, the IRS adjusted the total value of decedent's rights in the split-dollar arrangements from $183,700 to $9,611,624, the cash surrender value of the policies.

The estate moved for partial summary judgment. A court may grant summary judgment when there is no genuine dispute as to any material facts and a decision may be granted as a matter of law. The court first found that Section 2036 and Section 2038 would apply in this situation. The estate tried to argue that neither Section applied because the decedent retained no rights with respect to the amounts transferred to justify application of those Sections. However, the court noted that the decedent retained the right to terminate and recover at least the cash surrender value held in conjunction with the MB Trust and that those constituted rights under Section 2036 and Section 2038. The court then noted that with respect to the requirements in Sections 2036 and 2038, questions remained as to whether decedent's transfer of $10 million was part of a bona fide sale. It also noted that the issue of whether the transfer was for full and adequate consideration was a question of fact. It stated that the bona fide sale for adequate and full consideration exception was not satisfied because the value of what the decedent received was not even close to the value of what decedent paid.

The court also reviewed the argument of the government that Section 2703 would apply to the MB Trust's ability to veto termination of split-dollar arrangements. It found that split dollar agreements, taken as a whole, clearly restricted decedent's right to terminate the agreements and withdraw his investment from those arrangements. The court stated that the requirements of Sections 2703 were met and therefore denied the motion for summary judgment with respect to this. The court also noted that the parties had not addressed the exception in Section 2703(d) which provides for comparison with the terms of any similar arrangements entered into by persons in arms' length transactions.

The court also rejected the estate's contention that any part of the difference between the $183,700 that decedent allegedly received in return and the $10 million decedent paid would be accounted for as gifts and that to count the difference as part of the estate under Sections 2036, 2038 and 2703 would be double counting.

The estate also sought summary judgment that pursuant to Treas. Reg. § 1.61-22, the economic benefit regime would apply to split dollar arrangements. The IRS countered that the regulation did not apply for estate tax purposes and stated that the economic benefit regime rules only are gift tax rules. The court noted that to the extent that the regulations eliminated the gift tax treatment and that those transfers are relevant to the estate tax issues it would look at the regulations in deciding the case. The estate also argued that the court should modify the approach required by Sections 2036, 2038 and 2703 to avoid inconsistency between the statutes and the regulations. The court disagreed. First, it found no inconsistency between the estate tax statutes and the income tax regulations. It also disagreed with the estate's argument, which was confusing to the court, that because Treas. Reg. § 1.61-22 did not deem the difference to be a gift, then the entire $10 million transferred must have been for full and adequate consideration. As a result, the estate's motion for partial summary judgment was denied. The government did not move for summary judgment on any of the issues discussed.

The government and the estate settled on August 16, 2018. The estate conceded that the value of the decedent's rights in the split dollar arrangements was $9,611,624, the cash surrender value of the policies, the amount asserted by the government. The estate was also liable for a Section 6662 20 percent accuracy related penalty.

25. **<u>Estate of Frank D. Streightoff v. Commissioner,</u> ___ F.3d ___ (5th Cir. 2020)**

Fifth Circuit upholds decision of Tax Court imposing additional estate tax liability for limited partnership interest included in estate

This was an appeal to the Fifth Circuit in which the Fifth Circuit upheld the decision of the Tax Court in favor of the government. <u>See</u> <u>Estate of Frank D. Streightoff v. Commissioner</u>, T.C. Memo 2018 – 178.

On October 1, 2008, Frank D. Streightoff created a revocable living trust of which his daughter, Elizabeth Streightoff was the trustee. In addition, on October 1, 2008, Streightoff Investments, LP ("SILP") was created as a Texas limited liability partnership. Frank held an 88.99 percent limited partnership interest in SILP. Each of his daughters had a 1.54 percent limited partnership interest. His Sons and former daughter-in-law each held a .77 percent limited partnership interest.

The sole general partner of SILP was Streightoff Management which held a one percent ownership interest. Elizabeth was the managing member of Streightoff Management.

Finally, on October 1, 2008, Frank assigned his 88.99 percent interest in SILP to his revocable trust. The assignment of Frank's interest to the revocable trust was executed by Elizabeth as Frank's agent under his durable power of attorney. Elizabeth also signed the approval of the transfer as Streightoff Management's managing member (the general partner of SILP) and for the assignee as the trustee of the revocable trust.

Frank Streightoff subsequently died on May 6, 2011. Frank's estate (of which Elizabeth was executor) reported a taxable estate of $4,801,662 on its federal estate tax return. The estate listed the 88.99 percent interest in SILP as an assignee interest with a value of $4,588,000 as of the alternate valuation date. This valuation reflected discounts for lack of marketability, lack of control, and lack of liquidity.

Subsequently, the IRS issued a notice of deficiency of $491,750. The IRS increased the value of the estate's 88.99 percent interest in SILP to $5,993,000 as compared to the estate's valuation of $4,588,000. This represented an increase in value of $1,405,000 or approximately 31 percent. The IRS stated the value of Frank's interest in SILP could only be discounted for lack of marketability and not for lack of control and lack of liquidity.

In the proceedings before the Tax Court, the Tax Court rejected the estate's claim that the IRS's notice was subject to the provisions of the Administrative Procedures Act ("APA") on a motion for summary judgment. The Tax Court held that the APA did not apply to proceedings related to a redetermination of a deficiency. The Tax Court concluded that the Notice of Deficiency complied with the requirements of Section 7522(a) of the Internal Revenue Code.

At trial, the valuation experts for the estate and for the IRS were the only witnesses. The Tax Court determined that the revocable trust held a limited partnership interest in SILP at the alternate valuation date because the Assignment validly assigned the SILP interest as a limited partnership both in substance and form. As a result, the revocable trust held a limited partnership interest in SILP and not an assignee interest. See Estate of Frank D. Streightoff v. IRS, T.C. Memo 2018-178.

On appeal, Streightoff' s estate challenged the decision of the Tax Court on two grounds. First, the estate contended that in using a substance over form rationale to conclude that the estate held a limited partnership interest, the Tax Court's opinion was contrary to Texas partnership law. It also violated a doctrine set forth in Sec. & Exch. Comm'n v. Chenery Corp., 382 U.S. 194 (1947). Second, the estate asserted that the notice issued by the IRS failed to comply with both Section 7522(a) and the APA.

The court first noted that because the partnership agreement had specific provisions on the issue of the nature of the interest transferred, it was unnecessary to consult Texas law. It noted that Texas law provides that a court should look to the Texas Uniform Partnership Act for guidance only when the partnership agreement was silent. It also noted that the assignment was a" Permitted Transfer" under the provisions of Section 9.2, which permitted limited partners to transfer their interest to a member of the limited partner's family. Here, the decedent was the transferor under the assignment and basically and effectively assigned the interest to himself as a member of his family when he assigned the interest to the revocable trust.

Section 9.7 of the SILP Partnership Agreement provided the requirements for attaining legal status as either a transferee or assignee. To be admitted as a substituted limited partner, Section 9.7(b) required that the transferee receive its interest through a "Permitted Transfer" under Section 9.2. This provision was obviously satisfied.

The estate and the IRS diverged on the application Section 9.7(a), which required that the transferee obtain consent from the general partner of SILP. The Fifth Circuit found that Streightoff Management's managing partner, Elizabeth, had the unilateral decision-making authority to admit the assignment interest as a substituted limited partner. The estate argued that the requirements of Section 9.7(a) were not met because of an absence of the consent of Streightoff Management to admit the revocable trust as a substituted limited partner. The IRS believed that the broad language of the assignment transferred the decedent's full partnership rights to the revocable trust. When Elizabeth, as trustee of the revocable trust signed and, as manager of Streightoff Management, approved the assignment, she consented to the transfer of the decedent's 88.99 percent interest as a substituted limited partner interest.

The Fifth Circuit agreed with the IRS. It noted that the unambiguous language of the assignment purported to convey more than an assignee interest. The assignment stated that the decedent assigned "all and singular the rights and appurtenances thereunto in *anywise belonging*." This was more than a transfer of an assignee interest. In addition, Elizabeth signed the assignment under the legend "approved by."

The Fifth Circuit, from an economic reality standpoint, also agreed with the Tax Court's alternative substance over form rationale. The Tax Court stated, "regardless of whether as 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." The substance over form doctrine permits a court to determine if a transaction is characterized according to the underlying substance of the transaction rather than its legal form. The Fifth Circuit noted that the assignment lacked any economic substance outside of tax avoidance. It noted that there were no practical differences before and after the assignment was executed with respect to what managerial and oversight powers limited partners enjoyed that unadmitted assignees did not. Without any genuine nontax circumstances present, the assignment was the functional equivalent of a transfer of a limited partnership interest under Kerr v. Commissioner, 113 T.C. 449 (1999).

The Fifth Circuit also rejected the Chenery argument. There, a reviewing court in dealing with a determination or judgment, which an administrative agency alone is authorized to make, must judge the propriety of such action solely by the grounds invoked by the agency. That type of decision was not involved here because the Tax Court was determining the notice of tax deficiency de novo and not critiquing the determination of the IRS.

The Fifth Circuit also summarily dealt with the estate's arguments that the notice of deficiency failed to comply under the APA. The APA's judicial review proceedings were not intended to supplant existing statutory schemes that set forth clear pre-existing procedures for review such as the deficiency statute at review in this case.

The Fifth Circuit then affirmed the decision of the Tax Court.

26. **Kress v. United States, 372 F.Supp.3d 731, (E.D. Wis. 2019)**

Tax Court rejects IRS's valuation of minority interests in closely held S Corporation stock given to family members over three years

Kress involved gifts of stock in Green Bay Packaging, Inc., a closely held S Corporation based in Green Bay, Wisconsin ("GBP") to family members. GBP was a vertically integrated manufacturer of corrugated packaging and related products. It employed approximately 3,400 people in fourteen states. In addition to the operating business, GBP had non-operating assets, including two aircraft, certain unrelated investments, and group life insurance policies. Members of the Kress family owned approximately ninety percent of the common stock and employees and directors owned the remaining ten percent.

When GBP sold shares to its employees and directors, the purchase price for those shares was 120% of the book value of each share. No price was established for shares that were transferred to members of the Kress family. Certain restrictions limited the ability to sell both family owned shares and non-family owned shares. A right of first refusal restriction in the GBP bylaws required that employee or director shareholder give GBP written notice of his or her intent to sell and offer to sell the shares back to GBP before selling to others. With respect to family-owned shares, a bylaw restriction required that Kress family members only gift, bequeath or sell shares to other members of the Kress family.

Plaintiffs, James and Julie Kress, gave shares of GBP stock representing minority interests in the company to children and grandchildren in 2006, 2007, 2008 which gifts were reported on gift tax returns for 2007, 2008, and 2009 (and which the court referred to as the tax years in its analysis). The shares were valued as follows:

Gift Tax Year	Price Per Share
2007	$28.00
2008	$25.90
2009	$21.60

Each of the two donors paid $1,219,241 in gift taxes with respect to the gifted shares for a combined total gift tax of $2,438,482.

The IRS challenged the values reported on their gift tax returns and said that the fair market value of the stock equaled the price used for actual share transactions between GBP and its employees and directors which were:

Gift Tax Year	Price Per Share
2007	$45.97
2008	$47.63
2009	$50.85

The IRS issued a notice of deficiency, and the Kresses paid the additional gift tax totaling more than $2 million. The Kresses then filed amended gift tax returns seeking a refund for the additional gift taxes and accrued interest they paid. When the IRS failed to respond, the Kresses initiated the lawsuit in 2016 to recover the gift tax and interest assessed.

After ruling on procedural matters involving the admissibility of certain evidence, the district court determined that the Kresses successfully shifted the burden of proof with respect to the valuation of the gifted shares by introducing credible evidence to support their position (including the testimony of two experts), maintaining credible records, and cooperating with the government's reasonable requests for documents and information. However, the court, citing Estate of Stuller v. United States, 55 F.Supp.3d 1091 (C.D. Ill. 2014) noted that if both parties had met their burdens of production by presenting some evidence, the party supported by the weight of the evidence will prevail regardless of which party bore the initial burden of production or persuasion.

The government used Francis Burns of Global Economics Group as its expert in the case. Burns determined the fair market value of the gifted shares using both a market approach and an income approach and ascribing a weight to each approach. Burns weighted the market approach 60 percent and the income approach 40 percent to determine the fair market value. This calculation resulted in the following valuations for the stock given to the children and grandchildren.

Gift Tax Year	Price Per Share
2007	$38.40
2008	$27.81
2009	$40.05

Under the market approach, Burns identified nineteen to twenty companies that were in the same business as GBP; eliminated companies based on dissimilar characteristics, and identified four comparable companies for each year.

Under the income approach, Burns completed a capitalized cash flow analysis.

Burns' marketability discounts were significantly below those of the expert witnesses of plaintiffs. Burns assessed marketability discounts of 10.8 percent, 11.0 percent and 11.2 percent for the respective tax years. The court found that Burns' discounts for lack of marketability were "unreasonably low."

The court also noted that Burns applied a separate subchapter S premium to his valuation. Both Burns' and plaintiffs' expert, John Emory, applied C Corporation-level taxes to GBP's earnings to compare GBP to other C Corporations. Burns then assessed a premium to account for the tax advantages associated with subchapter S status such as the elimination of the one level of taxes that GBP did not pay. Burns also noted that GBP did not pay C-corporation taxes in any of the valuation years and did not expect to in the future. Plaintiffs' experts, John Emory and Nancy Czaplinski, did not consider subchapter S status to be a benefit that would add to the value of the minority shareholder's stock because a minority shareholder could not change GBP's corporate status. The court believed that GBP's subchapter S status should have a neutral impact.

The court also found that Burns improperly treated the non-operating assets by adding back their full, undiscounted value after the discount analysis addressed above.

Plaintiffs' first expert, John Emory, had his own valuation firm. Burns solely relied on a market approach and applied minority and marketability discounts to arrive at the value of minority shares in GBP. He determined the value per share of the stock as follows:

Gift Tax Year	Price Per Share
2007	$28.00
2008	$25.90
2009	$21.60

The IRS criticized Emory's valuation for ignoring the income approach to valuation, so plaintiffs retained Czaplinski who worked at Duff & Phelps. Using the income approach, Czaplinski calculated the value of the stock for the relevant years to be:

Gift Tax Year	**Price Per Share**
2007	$30.87
2008	$25.92
2009	$25.06

The court found Emory's valuation methodology the most sound, noting that he derived values through interviewing management at GBP, reviewing prior year reports, and analyzing the most relevant guideline companies and the multiples they yielded.

The IRS also asserted that the Kress' experts erred in considering the restriction of transfers between family members in the bylaws in calculating the lack of marketability discount. Generally, the valuation of any stock is determined without considering restrictions to sell the stock under section 2708. Plaintiffs maintained that the restriction meant all three requirements under section 2703A because it:

1. was a bona fide business arrangement;
2. was not a device to transfer property to members of the decedent's family for less than full and adequate consideration; and
3. included terms that are comparable to similar arrangements entered into by persons in arm's-length transactions.

The court agreed that plaintiffs had shown that the restriction was a bona fide business arrangement and was not a device to transfer property to members of the decedent's family for less than full and adequate consideration. However, the court found that the Kresses had not submitted specific evidence showing that the restriction was comparable to similar arrangements entered into by persons in an arm's-length transaction. Though the Kresses contended that restrictions like the GBP family restrictions were common to the commercial world, they did not produce any evidence that unrelated parties dealing at arm's length would agree to such an arrangement.

The court did not fully accept Emory's discounts for lack of marketability. Instead, the court held that a 27 percent discount for lack of marketability for 2006 and 2007 and a 25 percent discount for lack of marketability for 2008 were more fitting. It noted that Emory's report only gave minimal consideration to the restrictions in the bylaws to transfers to family members, but that any consideration of that or other restriction was improper. As a result, a 3 percent downward adjustment was the appropriate. As a result, the value of the stock for give tax purposes was:

Gift Tax Year	**Price Per Share**
2007	$29.20
2008	$27.01
2009	$22.50

27. **Carter v. United States _____ F. Supp. 3d ___ (N.D. Ala. 2019)**

Court rejects attempt of estate to obtain refund for stock that it alleged was over-valued on the alternate valuation date as a result of fraud

Elizabeth Carter was the personal representative of the Estate of Frances E. P. Roper. Frances Roper died on December 21, 2007. On the date of her death, Frances Roper owned 567,092 shares of Colonial BancGroup stock with a market value of $17,604,767. Frances Roper bequeathed the bulk of her estate, consisting primarily of Colonial BancGroup's stock, to her niece, Elizabeth Carter, and her nephew, Randy Roper. Within six months after Frances Roper's death, the market value of the stock decreased to $8,548,947.

The estate filed a federal estate tax return using the alternate valuation date and reported an estate tax of $6,261,530. On April 26, 2009, the estate filed an amended return reporting a slightly lower tax of $6,169,892. The Colonial stock represented 46.8 percent of the value of the gross estate. The IRS accepted the amended return and issued a refund.

Four years later, on September 13, 2013, the estate filed a refund claim with the IRS, alleging that it overpaid its estate tax by $3,731,616 due to a criminal fraud perpetrated against Colonial by one of its customers. Elizabeth Carter alleged that Colonial Bank and its executives urged them not to sell their shares as the price declined. Instead Elizabeth Carter and her brother, Randy Roper, obtained a loan from Colonial for which Colonial required personal guarantees (and on which they remained personally liable). As a result of the fraud, on August 14, 2009, the Alabama State Banking Department closed Colonial Bank and the FDIC assumed receivership over the bank. By December 17, 2010, Colonial's stock closed at $ 0.07 per share and could no longer be publicly traded.

The estate asserted that it did not have to rely upon the stock's publicly traded median price on the alternate valuation date due to the criminal fraud involving the bank. The IRS denied the claim. The estate then commenced an action seeking a refund of the overpaid estate tax. The government moved to dismiss on the basis of lack of subject matter jurisdiction and lack of merit. The estate sought the dismissal of this first action without prejudice which the government did not oppose in which the court granted without prejudice on May 12, 2016.

The estate filed a second refund claim on August 26, 2016 on the same grounds as the earlier refund claim. In addition, the claim was accompanied by the medical opinion of Elizabeth Carter's treating physician in which the physician declared that Elizabeth Carter suffered from a medical impairment for over five years which had prevented her from managing the estate's affairs.

The government opposed the second refund claim on two grounds. The first ground was that the court lacked subject matter jurisdiction. The second was that if subject matter jurisdiction existed, the estate's claim lacked merit. The district court found that the court lacked subject matter jurisdiction. Section 6511(a) requires that a claim for refund must be filed within three years from the time the return was filed or two years from the time the tax was paid, whichever period expires later. The court found that the estate had clearly missed the deadline for filing a refund claim and violated the provisions of Section 6511(a). The court noted that when the estate filed its claims in 2013 and 2016, the limitations period under Section 6511(a) for submitting such a claim had lapsed because the estate had filed its tax returns in 2008 and 2009. As a result, the court lacked jurisdiction.

However, the estate invoked the financial disability exception of Section 6511(h) to argue that the time to file the refund claim had been tolled. The court disagreed and held that the financial disability of the estate's personal representative did not extend the filing deadline for the estate to seek a refund. Section 6511(h) permits the suspension of filing deadline while a taxpayer is unable to manage his or her financial affairs due to a disability. Elizabeth Carter asserted that from the fall of 2008 to the end of 2013, she suffered from moderate to severe mental and emotional abnormalities which rendered her incapable of managing the estate's financial affairs. She provided the declaration of her treating physician to support this contention. Both Elizabeth Carter and the physician attested that the trauma from the complete devaluation of Colonial stock caused her ailments. The court however found that estates are not "individuals" subject to the provisions of Section 6511(h). Consequently, Elizabeth Carter could not invoke her financial disability to toll the time for the estate's refund claim.

Then, the court addressed the valuation of the Colonial stock assuming that Section 6511(h) tolled the time for the estate to file its refund claim. The court held that the devaluation of the Colonial stock due to fraud established no entitlement to refund. The court noted that the value of the Colonial stock on both the date of Frances Roper's death and the alternate valuation date could be determined based on the publicly traded value on a stock exchange. Elizabeth Carter, as executor, contended that the Colonial stock was worthless at the time of its valuation due to the fraud. However, the fraud did not become known and affect the value of the stock until more than one year after the alternate valuation date used by the estate. Until the fraud affected the exchange price, the fraud had no impact on the stock's fair market value. Had the estate sold the stock on the alternate valuation date, the estate would have received the market price for the stock as of that date and that was the appropriate valuation. The court noted in conclusion that while it was sympathetic to the executor's plight in these circumstances, it could not invoke its equitable powers to fashion relief against the "ravages wreaked by the criminal fraud."

28. **<u>Estate of Aaron U. Jones v. Commissioner</u>, T.C. Memo 2019-101**

Tax Court determines gift tax value of limited partnership units in voting and non-voting shares of stock in related timber land management and lumber entities

This case involves the valuation for gift tax purposes of voting and non-voting stock in the Seneca Sawmill Company, an S Corporation (SSC), and Seneca Jones Timber Company, a limited partnership (SJTC). Aaron Jones was the founder of both entities. SSC manufactured lumber. SJTC owned timber over 155,000 acres in western Oregon and supplied much of the timber for SSC's milling operations. Jones had started SJTC when he became concerned that he would lose access to sufficient timber for SSC from federal lands. Aaron Jones owned the bulk of the shares or units in each entity and each of his three daughters owned a small interest.

SJTC and SSC, while separate legal entities, operated in tandem in furtherance of SSC's sawmill business. SJTC's management team was identical to that of SSC and was paid by SSC. SSC acted as the general partner for SJTC, made all management decisions for SJTC, and had full control over SJTC's business. Under SJTC's partnership agreement, the limited partners were restricted in their ability to transfer their interest in SJTC. The consent of all partners was required for the substitution of a transferee of SJTC partnership units as limited partner. Limited partners were also subject to a buy/sell agreement, which restricted transfers of their interests in SJTC. Likewise, SSC's shareholders could not sell, gift, or transfer their stock unless they did so in compliance with SSC's buy/sell agreement.

As part of the succession plan that he began in 1996, Mr. Jones formed family and generation-skipping trusts on May 28, 2009, to which interest in the companies were to be transferred as gifts. He gave blocks of voting and non-voting stock in SSC to the different trusts. He also gave blocks of limited partner units in SJTC (and small interests with minimal value in another entity) to his daughters and to the different trusts. Jones signed net gift agreements with each of his daughters in which his daughters assumed liability for the gift and estate tax associated with the transfers.

Jones filed a gift tax return reporting the gifts. On the gift tax return, the SSC Class A (voting), the SSC Class B stock (nonvoting), and the SJTC units were valued respectively at $325, $207, and $320 per unit. The Internal Revenue Service issued a notice of deficiency in 2013 in which it determined additional gift tax owed of $44,986,416. Jones died in 2014 and his estate became responsible for handling the alleged gift deficiency with the Service.

The estate and the Service were unable to reach agreement and matter went to the Tax Court. In the course of this proceeding, the estate increased the fair market values of the SSC Class A stock, the SSC Class B stock, and SJTC interests tm $390, $380, and $380 per unit respectively. The IRS valued the SSC Class A voting shares at $1,395 per share, the SSC Class B non-voting shares at $1,325, per share and the SJTC limited partnership units at $2,511 per unit in its notice of deficiency. The IRS subsequently increased its valuation of the limited partnership units from $2,511 to $2,530 per unit.

The case boiled down to which expert's opinion the court would accept. The court accepted the estate's expert and not the government's. The estate's expert, Richard Reilly, used the discounted cash flow method and a market approach in valuing the shares and the units. Reilly found that SSC was worth $20,000,000 on a non-controlling, non-marketable basis after adjustments and discounts and calculated a value of $390 per share of Class A voting stock on the basis of the number of outstanding shares. He applied a three percent discount for the lack of voting rights and determined a $380 value per share for the Class B Non-Voting Stock.

Reilly concluded that SJTC was worth $21,000,000 on a non-controlling, non-marketable 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 non-controllable market value of limited partnership units transferred was $3,901,715.

The IRS' expert, Philip Schwab valued SJTC as a going concern and relied on a net asset value method approach and a market approach in valuing SJTC's limited partnership units. After applying adjustments and discounts, Schwab determined the value of SJTC on a non-controlling, non-marketable basis was a $140,398,000. He determined a value of $2,530 per limited partner unit.

John Ashbrook was the IRS' rebuttal expert with respect to Reilly's valuation of the SSC stock. The primary dispute between the parties was whether SJTC should be valued using the income approach or an asset based approach. In addition, the parties had other points of dispute: The reliability of revised projections in 2009; the propriety of taking tax affecting into account in the valuation of SSC; the proper treatment of intercompany loans from SSC to SJTC, the proper treatment of SSC's ten percent general partner interest in SJTC: and the appropriate discount rate for lack of marketability.

The estate contended that SJTC was an operating company that sold a product and therefore should be valued as a going concern with primary consideration to its earnings. It also argued the SSC and SJTC were so closely connected that they should be treated as one entity for valuation purposes. The estate rejected an asset-based valuation because there was no likelihood of SJTC selling the timberland. The government contended that SJTC was a natural resource holding company and that the value of its timberland should be given primary consideration in value. The government also argued that the SSC and SJTC were independent entities that should be valued separately.

The Tax Court, in its examination, relied upon <u>Estate of Giustina v. Commissioner</u>, 586 F .App'x 417 9t Cir. 2014). The court concluded that SJTC and SSC were so closely aligned and interdependent that it was appropriate to take into account its relationship with SSC and vice versa. This did not ignore the status of SJTC and SSC as separate legal entities, but recognized their economic relationship and its effect on their valuations. The court also accepted the argument of the estate that under the partnership agreement, holders of blocks of limited partnership units could not force the sale of its timberland and that SSC would never actually sell the timberland. The court concluded that an income based approach rather than a net asset valuation method approach should be used.

The court then noted that Reilly had relied upon revised projections from April 2009 in determining discounted cash flow and had tax affected the earnings before interest and taxes in projecting the earnings. While SSC normally did year-end projections, in the midst of the recession in early 2009, SSC's management team completed revised financial projections for both SJTC and SSC to assess its ability to comply with loan covenants and operate in an increasingly challenging economic environment. The management team had used the same method to make the April 2009 projections that it used to complete its regular yearly financial projections. The April 2009 projection were more pessimistic results than the year-end projections. The government disagreed with the use of the more pessimistic April 2009 projections, but the court accepted the use since the April 2009 projections were the closest in time to the gifts that were made in May 2009. The court also accepted the use of tax affecting in determining SJTC's earnings. Reilly used 38 percent as a proxy for the combined federal and state tax burdens that the owners of SJTC would bear (in effect treating SJTC as a C corporation. The court also noted that while the government "vociferously" objected to tax affecting, its experts were basically silent and referred to this as a fight between the lawyers and not between the valuation experts.

The court also looked at the market approach in which Reilly and Schwab both used the guideline public company method for valuing SJTC. The court thought that Reilly's analysis was better than Schwab's. As a result, the valuations of Reilly were accepted for gift tax purposes. The court rejected the government's arguments that the intercompany debt should be added in as a non-operating asset since the interest income and expenses were accounted for in the discounted cash flow valuation method used by Reilly.

The court noted that the government did not submit a valuation of SSC and largely accepted the values of $390 for a Class A voting share and $380 for a Class B nonvoting share. The court almost summarily rejected the three criticisms of the government of Reilly's valuation:

1. Improperly treating SSC's $32.7 million receivable from SJTC as an operating asset;
2. Improperly treating SSC's general partner interest in SJTC as an operating asset and thus improperly accounted for in the value of SSC; and
3. Tax-affecting the discounted cash flow method of valuing SSC.

The court noted that the advancements from SSC to SJTC were not investments. They were, instead, cash transfers between intercompany accounts of a single business enterprise to pay down debt to third party lenders. SSC's controlling interest in SJTC ensured that SSC and SJTC could be operated as a single business enterprise which was an operating company and therefore Reilly's use of expected distributions to represent the value of the general partner interest to SSC was reasonable. The court found that using tax affecting for valuing SSC was appropriate for that same reasons that the court found tax affecting appropriate for valuing SJTC.

Finally the court accepted Reilly's 35 percent discount for lack of marketability which was based on SJTC's unique characteristics including the buy-sell agreement, the lack of historic transfers, a potentially indefinite holding period, a reported loss in the twelve months before the gifts were made, and the unpredictability of partner distributions.

The court adopted the valuations in Reilly's report thus giving the taxpayers a victory.

29. **CCA 201939002 (Issued May 28, 2019; Released September 27, 2019)**

Determination of fair market value of publicly traded stock for gift tax purposes should take pending merger into account

The donor was a co-founder and chairman of board of Corporation A, a publicly traded corporation. The donor transferred shares of Corporation A stock to a grantor retained annuity trust with a remainder to children. Subsequently, Corporation A announced a merger with Corporation B. The merger was the culmination of negotiations with multiple parties. Prior to the date of the gift of the stock to the GRAT, Corporation A held exclusive negotiations with Corporation B. On the day of trading after the announcement of the merger, the value of Corporation A's stock increased substantially, although less than the agreed merger price. The merger was subsequently consummated.

The memorandum did say that fair-market value is the price that a hypothetical willing buyer would pay a hypothetical willing seller, neither being under any compulsion to buy or to sell, both having reasonable knowledge of relevant facts. Treas. Reg. § 25.2512-1; Rev. Rul. 59-60, 1959-1 C.B. 237. Moreover, a valuation of property for estate and gift tax purposes is made as of the valuation date without taking account of subsequent events.

The IRS, in reviewing the transaction, found that the records supported a finding that, as of date of the gift, a hypothetical willing buyer of the stock could have reasonably foreseen the merger and anticipated that Corporation A's stock would trade at a premium. While the sale price of stocks and bonds on the date of the gift is the usually the fair-market value, Treas. Reg. § 25.2512-2(e) provides that in cases in which the sale price of the stock or bond does not represent the fair-market value, then some reasonable modification to the sales price on the date of the gift or other relevant facts and elements of value shall be considered in determining the fair-market value.

The memorandum cited to Silverman v. Commissioner, T.C. Memo. 1974-285, aff'd., 538 F.2d. 927 (2d Cir. 1976), cert denied, 431 U.S. 938 (1937) in which taxpayers 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. The Tax Court also cited to Ferguson v. Commissioner, 174 F. 2d.997 (9th Cir. 1999), which affirmed the Tax Court's prior decision, 108 T.C. 244 (1997). In Ferguson, the appellate court considered the issue of whether the taxpayers who gave stock in a publicly traded company to different charities shortly before the sale of the company were liable for the capital gains tax on the sale of the appreciated securities under the anticipatory assignment of income doctrine.

In Ferguson, the taxpayers owned 18 percent of a publicly traded company and served as officers and on the board of directors. The board of directors authorized an investment bank to find a purchaser and to assist in negotiations. By July 1989, the company entered into a merger agreement. On August 3, 1988 a tender offer was started. On August 15, taxpayers executed a donation-in-kind record with respect to their intention to donate stock to a charity and two foundations. On September 9, 1980, the charity and foundations tendered their stock. On September 12, 1980 the final shares were tendered. On October 14, 1988, the merger was completed. The court concluded that the transfers to the charity and the foundations occurred after the shares in the company had ripened from an interest in a viable corporation into a fixed right to receive cash. Consequently, the assignment of income doctrine applied and the taxpayer's realized gain when the charity and the foundations disposed of the stock.

The memorandum states that the current situation was similar factually to Ferguson, especially on the issue as to whether the fair-market value of the stock should take into consideration the likelihood of the merger as of the date of the donor's transfer of stock in Corporation A to the GRAT. The memorandum states that the Ferguson and Silverman opinions support the conclusion that the value of the stock in corporation must take in to consideration the pending merger. As a result, the value determined on the basis of the sales price on the date of the gift did not represent the fair-market value of the shares as of the valuation date. Relevant facts and elements other than the sales price must be considered in determining fair-market value. The memorandum also states that under the fair-market value standard, the hypothetical willing buyer and willing seller as of the transfer date 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. It goes on to state that to ignore the facts and circumstances of the pending merger would undermine the basic tenants of fair market value, and yield a baseless valuation.

The government does not address in this memorandum the possibility that the market may already have built the possible merger into the price of the stock in Corporation A. Moreover, Silverman would appear to be less than relevant because it deals with stock in a closely held corporation, while Ferguson does not deal with a gift of stock, but with the issue of whether the donors of appreciated stock to charity were responsible for the payment of capital gains tax because a tender offer had ripened sufficiently to subject the gift to the anticipatory income doctrine. Finally, one might raise the question of why a third party purchaser would pay a premium when that purchaser could pay the market price of a publicly traded security.

30. Estate of Moore v. Commissioner, T.C. Memo 2020-40

Tax Court holds that assets in family limited partnership should be taxed in decedent's estate at their full fair market value

This case is an example of quite aggressive estate planning which leads to bad facts making bad law. The facts in Moore are some of the most extreme that have ever underlain a case involving the availability of discounts for interests held in family limited partnerships and limited liability companies at a decedent's death.

Howard Moore rose from a birth in rural poverty to build a thriving and lucrative farm in Arizona. In September 2004, he began to negotiate the sale of the farm, but his health went bad. He was released from the hospital and entered hospice care by the end of 2004. Only then did Moore begin to plan his estate.

Moore's lawyer developed a complex plan consisting of five trusts and a partnership. The plan required Moore to contribute most of his farm to the partnership. Moore's stated reason was to protect the farm from various business risks and to bring his sometimes fractious family together to run and manage the business without him. However, five days after the partnership received part ownership of the farm, Moore sold it. Even after the sale, Moore remained on the farm and directed its operations until his death.

The court noted that the key question before it was whether Moore's complex estate plan reduced the size of his taxable estate. The court also had to determine whether Moore's efforts to reduce the size of his taxable estate resulted in taxable gifts.

Moore was born in poverty and had a difficult upbringing. His formal education ended in the eighth grade. Through hard work Moore was able to acquire more than a thousand acres in the Dome Valley near Yuma, Arizona. Moore was quite rough on his four children and often played his three Sons against each other to motivate them. He also had one daughter. Moore also suffered from a long battle of alcoholism before going to a rehab facility for help.

Moore began to think about selling the farm and in 2004, when he was 89, Moore became more focused on selling the farm. Before Moore could complete a sale to a neighbor, Mellon Farms, he had congestive heart failure, a heart attack, heat stroke, and was unable to breathe on his own. He insisted on returning home and was put on hospice care because he was given less than six months to live. Moore continued to work and a priority was to put his affairs in order.

At the end of December 2004, Moore called Bradley Hahn, an estate planning attorney with fifteen years of specialization in estate planning. Hahn had previously worked on Mrs. Moore's estate plan.

Moore's description of his estate planning goals focused primarily on maintaining control and eliminating estate tax. Other goals included the maintenance of his customary lifestyle, providing adequate liquidity for emergencies and investment opportunities, sufficient cash flow to make annual gifts to his children, the equal treatment of his children (although his son, Virgil, was to get his residence, his son, Ronnie was to get ½ of his interest in RRCH Moore Custom Farming and all of his interest in Yuma Speedway, LLC, and his grandson, Chet, was to get ½ of his interest in RRCH Moore Custom Farming), creditor protection, and the reduction of income, and estate taxes.

In order to accomplish his goals, Moore, with Hahn's help, four days after being discharged from the hospital, on December 20, 2004 created the following trusts:

1. Howard V. Moore Living Trust
2. Howard V. Moore Charitable Lead Annuity Trust
3. Howard V. Moore Children's Trust
4. Howard V. Moore Family Management Trust
5. Howard V. Moore Irrevocable Trust

Moore also created the Howard V. Moore Family Living Partnership.

Moore was trustee of the Living Trust with his Son, Virgil, and his daughter, Lynda. Moore transferred all of his real and intangible personal property to the Living Trust, including his farm, which went under the name "Moore Farms." Upon his death, the remaining trust property was divided between the charitable lead annuity trust (referred to in the opinion as the "Charitable Trust") and the Children's Trust.

The Charitable Trust was to make distributions to the Howard V. Moore Foundation, which would then contribute money to the Community Foundation for Southern Arizona where the distribution would be distributed among several charities as determined by the boards of the Moore Foundation and the Community Foundation. The purpose of the Charitable Trust was to provide a vehicle through which the four children could remain on speaking terms.

The amount to be distributed by the Living Trust to the Charitable Trust was defined as a fraction of the full estate that would result in the least possible federal estate tax being paid as a result of Moore's death taking into account the applicable exclusion amounts. The Charitable Trust at the time of the trial, had donated a total of $2.5 million to the Community Foundation. However, Hahn testified that the purpose of the trust was to provide a vehicle through which Moore's children would keep on speaking terms.

The remainder of the Living Trust property was to be distributed at Moore's death to the Children's Trust which, in turn, provided for the distribution of the remaining trust property to each of the four children in equal shares. The Children's Trust also contained the gifts of the specific assets that Moore including the gift of the residence to Virgil and the gift of Moore's ½ interest in RCCH Moore Custom Farming and Moore's 100 percent interest in Yuma Speedway, LLC.

The only purpose of the Management Trust was to be a partner in the Family Limited Partnership. Its only asset was a one percent interest in the Family Limited Partnership. The initial trustees were Virgil and Lynda and its designated beneficiary was Moore. Upon Moore's death, the remaining assets in the Management Trust were to be transferred to each of the four children through the Living Trust.

The Irrevocable Trust was initially funded with $10 with Virgil as its trustee and Moore's children as the beneficiaries. Subsequently, interests in the Family Limited Partnership were sold to it. The Irrevocable Trust provided for discretionary distribution of income and principal to the children. It also contained a provision for the transfer to the Living Trust of the amount of any asset included in Moore's estate. Following Moore's death, the Irrevocable Trust transferred large sums to the Charitable Trust. For example, from 2007 to 2009, the Charitable Trust made three payments to the Foundation of $790,000, $433,818, and $433,818 respectively.

In addition to the five trusts, Moore also set up the Family Limited Partnership on December 20, 2004. The Tax Court referred to the Family Limited Partnership as the "keystone" of Moore's estate plan. The Management Trust, the Living Trust, and the four children each made a total initial contribution of $10,000. These transfers gave each contributor a one percent interest. In addition, one Son, Ronnie, contributed his partial interest in another farm, (called Doval Farm) to the Family Limited Partnership in what the court described as a roundabout way. First Ronnie and Moore deeded their separate interest in Doval Farm to the Living Trust. The Living Trust then contributed

Doval Farms to the Family Limited Partnership along with 4/5ths of Moore's farm. In return, the Living Trust received a 94 percent interest (and then had 95 percent of the interests in total).

During trial, Moore's Son maintained that the purpose of the Family Limited Partnership was to protect against liabilities, creditors, and bad marriage and to help bring the family together. Under the family limited partnership agreement, no single partner could transfer or sell any interest without the unanimous consent of the remainder of the family. The limited partners had no right to participate in the business or management decisions. In Moore's last months, he negotiated the sale of Moore Farms. Moore Farms was under contract with Mellon Farms for $16,512,000 within five days after Moore contributed Moore Farms to the Living Trust. The court noted that even though the Family Limited Partnership held 4/5ths of the interests in the Moore Farms, the decision to sell was made solely by Moore. Moore continued to live on the property after his death (which was not unusual in the Dome Valley when a long held family farm was sold).

After the creation and funding of the trusts and the Family Limited Partnership, Moore had other items to complete.

The first was the payment of attorneys' fees to Hahn for the estate planning which totaled $320,000. Part of the payment came from the Family Limited Partnership shares and proceeds from the sale of the farm, and part came out of the Living Trust.

Moore also had the Family Limited Partnership issue a check for $500,000 to each of his four children. Moore required each child to sign a promissory note for the money, which was to be paid back on or before February 2020 at a stated rate of interest. None of Moore's children made payments of principal and interest and the Family Limited Partnership made no effort to collect. Moore's grandson, Chet, also received a $500,000 check which was actually a gift. The Family Limited Partnership then paid $2,000,000 to the Living Trust to be used to cover expenses of the land sale, various miscellaneous items, and income taxes owed on the sale of the farms.

Subsequently, Moore appears to have engaged in a sale to a defective grantor trust transaction. First, Moore's Living Trust s transferred $500,000 to the Irrevocable Trust. This transfer was reported on Moore's 2005 gift tax return as a gift of $125,000 to each of the four children. Two weeks later, the Living Trust transferred its entire interest in the Family Limited Partnership to the Irrevocable Trust for $500,000 in cash and a note for $4.8 million. Moore died shortly thereafter at the end of March 2005. After his death, the Living Trust covered many of his final expenses including a flat fee to Bradley Hahn of $475,000 for the administration of the estate (in addition to Hahn's fees of $320,000 for designing the estate plan)..

Moore's 2005 gift tax return reported the $500,000 gift to Chet and the four separate $125,000 gifts to each of Moore's children.

The Internal Revenue Service reviewed the estate tax return and determined an estate tax deficiency of $6.4 million. It also determined a gift tax liability of more than $1.3 million in 2005.

At trial, The Tax Court examined four issues.

1. Would the underlying value of the farm be taxed in Moore's estate under Section 2036 despite its sale through the Family Limited Partnership?

2. If some value of the farm was included in the estate, did the subsequent transfer of the Living Trust's Family Limited Partnership interest to the Irrevocable Trust remove that value?

3. Could Moore's estate could deduct a $2 million debt payable to the Family Limited Partnership, future charitable contribution deductions through the Charitable Trust, and $475,000 in attorney fees?

4. Whether Moore's transfers of $500,000 to each of his children were gifts or loans?

In the Tax Court proceedings, the IRS viewed Moore's estate plan as "nothing more than a last minute, last ditch effort to avoid paying tax." It argued that Section 2036 should apply because the transfer of 4/5ths of the farm to the Family Limited Partnership was not a bona fide sale for full and adequate consideration since Moore lacked legitimate non-tax reasons for forming the Family Limited Partnership and because Moore kept possession and enjoyment of the farm even after its sale. Thus, Moore had a retained use and enjoyment of the property under Section 2036(a)(1). The IRS also argued that Moore's retention of control over the Family Limited Partnership was a power to control the use and enjoyment of the property by others under Section 2036(a)(2). As a backup argument, the IRS argued that the subsequent sale of the Living Trust's interests in the Family Limited Partnership to the Irrevocable Trust was not a bona fide sale for full and adequate consideration but a deemed gift. This should also cause the value of the underlying assets in the Family Limited Partnership to added back into the estate.

The IRS disputed the availability of the estate tax charitable deduction for amounts transferred to Charitable Trust because the amounts passing to charity could not be determined as of the date of Moore's death and were contingent on the IRS's examination of the estate tax return. The IRS argued against the deduction of the attorneys' fees either because they were not incurred in the administration of the estate or they were unreasonably high.

Finally, the IRS argued that the $500,000 cash payments to the four children were gifts and not loans.

The court first looked at the applicability of Section 2036. Using the test in Estate of Bongard v. IRS, 124 T.C. 95 (2005), a transfer will not be respected if:

1. The decedent made an inter vivos transfer of property;

2. The decedent's transfer was not a bona fide sale for adequate and full consideration; and

3. The decedent retained an interest of right in the transfer property.

The court noted that whether a transfer was for adequate and full consideration is a question of value. Whether a transfer of property was bona fide turns on motive. The court then noted that under Bongard, the sale is bona fide only if there is a legitimate and significant non-tax reason for creation of the Family Limited Partnership. Moore's estate asserted that the principal reason for the formation of the Family Limited Partnership and transferring the interest in Moore Farms to the Family Limited Partnership was to bring the family together so they could learn how to manage the business without Moore. However, the court noted that after the sale of the farm, the only assets left in the Family Limited Partnership were liquid and an investment advisor managed them, not the family members. At trial, the Sons maintained the Family Limited Partnership also provided protection from creditors. The court said that protection from creditors can be considered a legitimate, but not significant, non-tax reason to form a family limited partnership. Moreover, no credible evidence had been introduced that any of the children had a legitimate concern with possible creditors' claims. The court also found other factors supporting a finding that the transfer was not bona fide. One was Moore's significant health problems and his desire to save millions of dollars of taxes. The second was his creation of a complex and extensive estate plan four days after being discharged from a hospital in critical condition and placed in the care of hospice. Finally, there was Moore's unilateral decision making and control of the entire process contradicted any assertion of a bona fide sale.

The court then reviewed as an alternate holding, whether Moore retained possession or enjoyment of the transferred interest after the transfer. This would be based on retaining a substantial present economic benefit. The court found that Moore continued to live on the property and continued to operate the farms as his own up until the date of his death. Even after the sale of the farm, Moore used the now liquid assets of the Family Limited Partnership to pay his expenses even though he kept sufficient assets of his own. This pattern was evidence of an implied agreement to retain the use of the property. Essentially Moore's relationship to assets in the assets of the Family Limited Partnership remained unchanged before and after the transfer. Consequently, because Moore retained possession or enjoyment of the assets in the Family Limited Partnership and because his transfer of part of the ownership of the Family Limited Partnership lacked a substantial non-tax purpose, the value of Moore Farms was to be included in the value of the estate under Section 2036 (a)(1).

Because the court concluded that Section 2036(a)(1) applied, it did not address the 2036(a)(2) or deemed gift arguments advanced by the IRS

The court then discussed the impact of the full Tax Court decision in Estate of Powell v. IRS, 148 T.C. 392 (2017) which analyzed, for the first time, the application of Section 2043(a) of the Code as it applied to family limited partnerships. In Powell, the court held that where Section 2036 compelled inclusion of the assets in a family limited partnership at the fair market value, Section 2033 also compelled inclusion of the partnership interests in the estate at the discounted value. Before, it had always been an "either or" analysis. Now, one must look at Section 2043(a). Section 2043(a) allows the estate to subtract the value of the partnership interest that is included under Section 2033 from the full value of the partnership assets included under Section 2036 to avoid double taxation. The facts made the application of Section 2043 easy in Powell because the date of death was shortly after the date of the transfer of assets to the Family Limited Partnership.

The facts did not make the application of Section 2043 in Moore easy, because any increase or decrease in the value of the underlying assets in the Family Limited Partnership and the Family

Limited Partnership interests themselves between the date of the transfer and the date of death must had to be taken into account. This causes a more complicated set of calculations.

The court then presented an equation to address the needed calculations, which read:

$$V_{included} = C_d + FMV_d – C_t.$$

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

C_d = the date of death value of the consideration received by the decedent from the transaction that remains in his estate (Section 2033);

FMV_d = fair market value at the 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).

The court then went through five examples of how this formula would work and noted that depending upon the facts, some of the examples must seem odd; however, the court had to apply the Code as it was written and interpreted and the full decision of the Tax Court in Powell. The five examples were:

Example 1: Constant Values

Example 2: Inflating Values

Example 3: Declining Values

Example 4: Discounted Interest, But Simple

Example 5: Discounted Interest, But Not Simple

The court then noted that the C_d variable was not limited by tracing rules. Essentially, whatever is left of the original consideration in the estate is included but so also are the proceeds from a later sale because Section 2033 includes all property that the decedent owns in his gross estate on the date of death. As a result, property that leaves an estate after a transfer governed by Section 2036 but before the decedent's death is generally not included in decedent's gross estate. The court then went through an extensive analysis of the facts in this case and it noted that determining the value of four-fifths of the farm that went from the Living Trust to the Family Limited Partnership in exchange for an interest in the FLP was difficult. The estate valued Moore's interest in the Family Limited Partnership at about \$5.3 million. The IRS argued that it was worth \$8.5 million.

After determining what the formula should be, but not the values that should be applied, the court then turned to the remaining issues.

The court also determined that the $500,000 "loans" by Moore to his children were" more likely than not" gifts. Some of the factors in making this determination were:

1. The notes had no fixed payment schedule;
2. The children paid no interest on the notes;
3. The children lacked the resources to pay off the notes;
4. The notes were not secured; and
5. The children did not set aside funds to repay the notes.

With respect to the availability of the estate tax charitable deduction for the distributions from the Living Trust to the charitable lead annuity trusts, the court held, based upon its review of the language, that the estate tax charitable deduction should be denied because the amount that would be transferred to charity could not be determined as of the date of death. The court then disallowed the deduction of the $475,000 of attorney's fees for the administration of the estate (over and above the $320,000 in fees for the estate planning), because there was no evidence that the fees were reasonably incurred in the administration of the estate or if they were, why the fees were so high. It noted that while New York courts might at least consider the reasonableness of fees based on a percentage of the gross estate, Arizona law required a court to look at other evidence, including billable hours and the type of work performed and use good judgment to decide the weight to give to each factor.

In closing, the court noted that the computations under the equation that it had presented would be difficult.

CHARITABLE GIFTS

31. **Hoffman Properties II, LP v. Commissioner, _____ F.3d _____ (6th Cir. 2020)**

Ability of donor to make changes to donated charitable easement whenever the donee fails to act within 45 days of notice of the proposed change violates the requirement that donation be perpetual

This was an appeal from the decision of the Tax Court.

Hoffman Properties owned a historic building in Cleveland, Ohio. Over ten years ago, Hoffman donated an easement in the façade of the building and certain airspace restrictions to the American Association of Historic Preservation "AAHP"). Under the conservation easement, Hoffman agreed not to alter the historical character of the façade or to build in the airspace above or next to the building. Hoffman then sought a $15 million income tax charitable deduction.

The IRS concluded that Hoffman was not entitled to an income tax charitable deduction because the donation was not "exclusively for conservation purposes" and did not meet the requirements for a "qualified conservation contribution" under Section 170(f)(3)(B)(iii). In later proceedings, the Tax Court agreed and granted summary judgment to the IRS. The Tax Court found that Hoffman's donation failed multiple requirements for a donation to be considered "exclusively for conservation purposes" under Section 170(h)(4)(B). The Sixth Circuit considered only one, which is that the conservation purposes must be protected in perpetuity under Section 170(h)(5)(A).

Hoffman reserved the right to make certain changes so long as the AAHP approved. AAHP's failure to act within 45 days of a receipt of a proposed change would be deemed to constitute approval and to permit Hoffman to undertake the proposed actions. In other words, Hoffman gave AAHP a 45-day window in which to prevent changes in the façade or airspace. The court then stated that "it almost goes without saying that this provision violated the perpetuities requirement."

Hoffman made several arguments, which the Sixth Circuit declined to accept. For example, Hoffman argued that the case fell within the narrow exception of the perpetuity requirement for remote future events. To fall within this exception, the possibility that the conservation purpose may be defeated must be "so remote as to be negligible." However, the Sixth Circuit interpreted the donation agreement as containing multiple terms that specifically addressed the possibility that the conservation purpose would be defeated. As a result, the decision of the Tax Court was upheld.

32. AM 2020-001 (Issued March 17, 2020; Released March 27, 2020)

IRS provides legal advice on amendment clauses for conservation easement deed

The issue in this memorandum from the Office of Chief Counsel of the Internal Revenue Service was whether a conservation easement failed to satisfy the requirements of Section 170(h) of the Internal Revenue Code as a matter of law if it contained an amendment clause.

The memorandum first noted that many cases involving the disallowance of an income tax charitable deduction for the contribution of a conservation easement are pending at the IRS. A significant number of these cases contain issues concerning the interpretation of the terms of the transfer deed and the effect of certain clauses including amendment clauses.

Section 170(h) provides various rules concerning qualified conservation contributions. To qualify, a contribution of a conservation easement must be used exclusively for conservation purposes. However, a contribution will not be treated as being used exclusively for conservation purposes unless the conservation purpose is protected in perpetuity.

An amendment clause must be considered in the context of the terms of the deed as a whole and the surrounding facts and circumstances to determine the rights, powers, obligations and duties of the parties on a case by case basis.

The memorandum noted that the following provision is compliant with the perpetuities requirements of Section 170(h):

> Grantee and Grantor may amend this easement to enhance the Property's conservation values or add real property subject to the restrictions set forth in this deed to the real property by an amended deed of easement provided that no amendment shall (i) affect this

> Easement's perpetual duration, (ii) permit development, improvements or uses prohibited by this Easement on its effective date, (iii) conflict with or be contrary to or inconsistent with the conservation purposes of this Easement, (iv) reduce the protection of the conservation values, (v) affect the qualification of this Easement as a qualified conservation contribution" or "interest in land", (vi) affect the status of the Grantee as a "qualified organization" or "eligible donee", or (vii) create an impermissible private benefit or private inurement in violation of federal tax law…

33. I.R. 2019-182 (November 12, 2019)

IRS increases enforcement action of Syndicated Conservation Easements

The Internal Revenue Service announced what it called "a significant increase in enforcement actions for syndicated conservation easement transactions, a priority compliance area for the agency", on November 12, 2019. It noted that coordinated examinations are being conducted across the IRS in the small business and self-employed division, the large business and international division, and the tax exempt and government entities division. Separate investigations have also been initiated by the IRS's criminal investigation division. According to the IRS, these audits and investigations cover billions of dollars of potentially inflated deductions as well as hundreds of partnerships and thousands of investors.

As the IRS put it:

> We will not stop in our pursuant of everyone involved in the creation, marketing, promotion and wrongful acquisition of artificial, highly inflated deductions based on these aggressive transactions. Every available enforcement auction will be considered, including civil penalties and, where appropriate, criminal investigations.

In Notice 2017-10 (December 2016) the IRS designated certain syndicated conservation easements as listed transactions. In specific, that notice listed transactions where investors and pass through entities received promotional material offering the possibility of charitable contribution deduction worth at least two and at one half times their investment. In many transactions, the deduction taken was significantly higher than 250 percent of the investment. These transactions are included on the IRS's 2019 "dirty dozen" list of tax scams to avoid. The IRS recognized that there are many legitimate conservation easements and that its compliance efforts were focused on the abusive syndicated conservation easement transactions. The IRS noted that it is pursuing investigations not only of participants, but also of promoters, appraisers, tax return preparers and others and will develop and assert all appropriate penalties. Such penalties include accuracy related penalties for participants, penalties for substantial and gross valuation misstatements attributable to incorrect appraisals for appraisers, and promoters. The IRS also noted that it is litigating cases where necessary with more than 80 currently docketed cases in the Tax Court on the availability and amount of income tax charitable deductions with respect to conservation easements.

34. **<u>Village at Effingham, v. Commissioner</u>, T.C. Memo 2020-102; <u>Riverside Place LLC v. Commissioner</u>, T.C. Memo 2020-103; <u>Maple Landing, LLC v. Commissioner</u>, T.C. Memo 2020-104; and <u>Englewood Place, LLC v. Commissioner</u>, T.C. Memo 2020-105**

Tax court denies income tax charitable deduction for donations of conservation easements

Each of these cases involve motions or cross-motions for partial summary judgment with respect to similar facts involving the same parties. In each case, a Georgia limited liability company had its principal place of business in Georgia. In December 2008, each LLC acquired a tract of land in Effingham County, Georgia from HRH Investments, LLC. Subsequently, in December 2010, each LLC donated a conservation easement over a specific number of acres of land to the Georgia Land Trust.

Each easement deed recited the conservation purposes and generally prohibited commercial residential developments. Each deed recognized the possibility that the easement might be extinguished at some future date. If the property were sold following that extinguishment, "the amount of the proceeds to which grantee shall be entitled, after the satisfaction of any and all prior claims, shall be determined, unless otherwise provided by Georgia law, in accordance with the Proceeds paragraph." The Proceeds paragraph specified that the grantee's share of any future proceeds would be determined by multiplying the fair market value of the property unencumbered by the conservation easement (minus any increase in value after the date of the conservation easement attributable to improvements) by the ratio of the value of the conservation easement at the time of the conveyance to the value of the property at the time of the conveyance without the deduction for the value of the conservation easement. A substantial income tax charitable deduction was taken for each donation. The deduction for the Village of Effingham was $5,237,000. The deduction for Riverside Place was $4,071,000. The deduction for Maple Landing was $6,791.000. The deduction for Englewood Place was $4,773,000.

The appraisal for the value of the easement was prepared by David R. Roberts. A Form 8283, Non-Cash Charitable Contribution, executed by David Roberts and the Georgia Land Trust was included with each LLC's income tax return. The Form 8283 stated that the basis of the donor in the property was not included because the basis of the property was not taken into consideration by the appraiser in computing the amount of the deduction.

The IRS denied the income tax charitable deductions and the parties filed cross-motions for partial summary judgment. The IRS asserted that the conservation purposes underlying the easement were not protected in perpetuity because the easement failed to comply with the regulations governing judicial extinguishment under Treas. Reg. § 1.170A-14(g)(6). The IRS also asserted that each LLC failed to attach a fully-completed appraisal summary on the Form 8283 because the appraisal summary did not include the donor's basis in the property. Each LLC stated that it had complied with regulatory requirements or if it had not, the regulations imposing the requirements related to inclusion of the basis were invalid.

The court rejected each LLC's arguments as it had done in previous cases involving substantially similar deeds of easement. It noted that the formula used to determine the grantee's proportionate share of post extinguishment proceeds was applied not to the full sale proceeds but to the proceeds minus any increase in value after the date of the easement attributable to improvements. This was an improper reduction and violated the requirement that easement be protected in perpetuity. If there was an extinguishment, the charitable donee must get its full share of the proceeds. The court also noted that the grantee's share of the proceeds would be further reduced through the satisfaction of any and all prior claims. This caused all prior claims to be assessed against the grantee's share of the proceeds even if those claims represented liabilities of the LLC or its successors.

The court next rejected the argument that the regulation on extinguishment was invalid. The court noted that it had addressed and rejected both arguments in a previous Tax Court-reviewed opinion. As a result, the conservation purpose underlying the easement was not protected in perpetuity as required by Section 170(h)(5)(A).

In addition, the court addressed the IRS' position that each LLC's income tax charitable deduction should be disallowed because of its failure to attach a properly completed appraisal summary. The court held that each LLC did not substantially comply because its failure to supply cost basis violated the essence of the statute. The disclosure of the donor's cost basis is an essential tool that Congress intended the IRS to have in the efficient identification of overvalued property. The court also rejected each LLC's contention that the regulations requiring disclosure of cost and other basis on the appraisal summary is invalid. As a result, the income tax charitable deduction for each of the LLCs conservation easements was denied.

35. **Estate of Dieringer v. Commissioner, 917 F.3d 1135 (9th Cir. 2019)**

Estate tax charitable deduction limited by post-death events

In Dieringer, the Ninth Circuit upheld the earlier decision of the Tax Court, 146. T.C. 117 (2016), with respect to both the deficiency in estate tax and the penalty imposed.

Decedent and family members owned DPI, a closely held real property management corporation. Decedent was the majority shareholder to DPI and owned 425 of the 525 voting shares and 7,736.5 of the 9,920.5 non-voting shares. While she was alive, decedent established a revocable trust and a foundation. Her son was the sole trustee of both the trust and the foundation. Decedent's will left her entire estate to the trust. Pursuant to the terms of the trust, $600,000 was to pass to various charities and decedent's children received minor amounts of her personal effects. The remainder of the estate, which would consist primarily of the DPI stock, was to be distributed to the acting trustee of the foundation. An appraisal determined the date of the death value of decedent's DPI non-voting and voting shares at $14,182,471. The voting stock was valued at $1,824 per share with no discount and the non-voting stock was valued at $1,733 per share which included a 5% discount to reflect the lack of the voting power. Numerous events occurred after decedent's death, but before decedent's property was transferred to the foundation. Seven months after decedent's death, DPI elected S-corporation status. DPI also agreed to redeem all of decedent's shares from the trust. DPI and the trust then amended and modified the redemption agreement. DPI agreed to redeem all 425 of the voting shares and 5,600.5 of the 7,736.5 non-voting shares. In exchange for the redemption, the trust received a short-term promissory note for $2,250,000 and a long term promissory note for $2,968,462. At the same time, three of decedent's sons purchased additional shares in DPI. The foundation later reported that it had received three non-cash contributions consisting of the short-term and long-term promissory notes and non-voting DPI shares. The total value of the two promissory notes was $5,218,462. The redemption was approved by an Oregon state court.

An appraisal of decedent's DPI stock for purposes of the redemption and subscription agreements determined that the voting shares had a fair market value of $916 per share and non-voting shares had a fair market value of $870 per share. The value of the DPI stock reported as received by the foundation from the trust was $1,858,961. The appraisal of the voting stock included discounts of 15% for lack of control and 35% for lack of marketability. The appraisal of the non-voting stock included the lack of control and marketability discounts plus an additional 5% discount for the lack of voting power at shareholder meetings.

On the federal and state estate tax returns, the estate reported no estate tax liability and claimed an estate tax charitable deduction of $18,812,181 which included the date of death value of decedent's DPI shares. The estate argued that the charitable deduction should not depend upon or be measured by the value received by the foundation. The IRS argued that the amount of the charitable contribution should be determined by post-death events.

The IRS agreed that normally the value of the estate tax charitable deduction is to be determined as of the moment of death and also agreed that the estate did not elect alternate valuation under Section 2032. It did argue that there are circumstances where the appropriate amount of a charitable contribution deduction does not equal the date of death value of the contributed property, citing Ahmanson Foundation v. United States, 674 F.2d. 761 (9th Cir. 1981). The estate argued that any consideration of post-death events also required finding that the decline in the value of the stock was due in part to market forces. The Tax Court had found no evidence to support a significant decline in the economy that would result in a fifty percent reduction in seven months.

The court agreed with the IRS and found that the value of the charitable contribution to the foundation was less than the date of death market value of bequeathed property because numerous events occurred after decedent's death that changed the nature of and reduced the value of the property actually transferred to the foundation and held that the estate was liable for an accuracy related penalty. The amount of additional estate tax owed was $4,124,717 and the accuracy related penalty was $824,943.

The court noted that the same appraiser valued the DPI stock for purposes of determining the date of death value of the property as well as the value for purposes of the redemption. The appraiser testified that for purposes of the redemption, he was specifically instructed to value that DPI stock as a minority interest. The court found that the brothers had thwarted decedent's testamentary plan by altering the date of death value of decedent's intended donation through a redemption of a majority interest as minority interest. It cited Treas. Reg. § 20.2055-2(b)(1) to the effect that if a trustee "is empowered to divert the property… to a use or purpose which would have rendered it, to the extent that it is subject to such power, not deductible had it been directly so bequeathed...the deduction will be limited to the portion, if any, of the property or fund which is exempt from an exercise of the power."

GENERATION-SKIPPING TRANSFER TAX

36. **Letter Rulings 202013001 to 202013005 (Issued October 7, 2019; Released March 27, 2020)**

Proposed modification of GST grandfathered trust will not have adverse generation-skipping tax consequences

Father and Mother created an irrevocable trust for the benefit of their Son prior to September 25, 1985 that would last until twenty-one years after the death of Son. Consequently, the trust was grandfathered from the GST tax. Subsequently, a local court approved a settlement agreement that provided that the trust would be partitioned into two separate trusts, Trust A and Trust B. With the exception of Son's wife, the beneficiaries of Trust A were different from the beneficiaries of Trust B. Son and his wife also released any power of appointment that they may have had over Trust A. Subsequently, the trustee of Trust A petitioned the local court to modify Trust A to provide that upon Son's death, Trust A was divided into separate shares for his heirs. Son's wife would receive one-third of Trust A and the other two-thirds would be divided into shares for the descendants of Son.

Son died and as a result of Son's death and various disclaimers, nine separate trusts were created from Trust A. Subsequent to Son's death, the trustees and advisory board members of Trust A and the successor trusts petitioned the local court to modify the trust to provide that if property is distributed upon the termination of Trust A to beneficiaries who had not reached a certain age, the trustee could make payment or distribution of that property to a vested continuing trust for the beneficiary. One-half of the assets of the continuing trust would be distributed to the beneficiary at a specific age and the balance at a subsequent age. Each beneficiary was given a testamentary general power of appointment. If the continuing beneficiary failed to exercise the general power of appointment, the property in the continuing trust would be distributed to the estate of the continuing beneficiary.

The trustees requested a ruling that the proposed modification would not cause Trust A or its successor trusts to lose their grandfathered exemption from GST tax.

In this ruling, Trust A was irrevocable prior to September 25, 1985. The amended trust agreement provided for outright distributions to the beneficiaries upon the termination of the trust and the successor trusts, which would occur 21 years after the death of Son. Each share upon the termination of Trust A or a successor trust distributed to a beneficiary under a particular age would be held in a vested trust for that beneficiary. The proposed modification would not result in the shift of any beneficial interest of any beneficiary who occupied a generation lower than persons holding the beneficial interests. The proposed modification would not extend the time for vesting of any beneficial interest in any trust. Thus, the modification fell within the parameters of Treas. Reg. § 26.2601-1(b)(4)(i)(D)(1) which provides that a modification in the governing instrument of an exempt trust by judicial reformation will not cause an exempt trust to be subject to generation-skipping tax if the modification does not shift a beneficial interest in the trust to a beneficiary who occupies a lower generation than the person or persons who held the interest prior to the modification and the modification does not extend the time for the vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

Since the requirements were met, the IRS ruled that the amendment of the trust would not ungrandfather the trust for generation-skipping tax purposes.

37. **Letter Rulings 202017009 and 202017010 (Issued November 25, 2019; Released April 24, 2020)**

Service grants donor and husband extension of time to opt out of automatic allocation of GST exemption

Donor and husband created five irrevocable trusts. Each trust was for the benefit of a single beneficiary and had GST potential. Donor and husband split the gifts. Donor and husband relied upon an attorney at the family office to prepare the gift tax returns reporting the transfers of property to the trusts. The attorney failed to advise the taxpayers of the rules regarding the automatic allocation of GST exemption under Section 2632(c) and the ability to opt out of the automatic allocation of GST exemption by making an election on the gift tax returns. As a result, GST exemption was automatically allocated to the trusts.

The taxpayers request an extension of time under Treas. Reg. § 301.9100-1 and 301.9100-3 to elect out of the automatic allocation of GST exemption to the five trusts and the Service granted the request. Under Treas. Reg. 301-9100-3, a request for relief will be granted when the taxpayer shows that the taxpayer acted reasonably and in good faith and the grant of relief will not prejudice the interests of the government. A taxpayer is deemed to have acted reasonably and in good faith when the taxpayer reasonably relied on a tax professional and the tax professional failed to make or advise the taxpayer to make an election. The Service found that this standard had been met in the fact situation in these rulings.

38. **Letter Rulings 202014006 – 202014010 (Issued October 16, 2019; Released April 3, 2020); 202015005 – 202015013 (Issued October 12, 2019; Released April 10, 2020); 202017001 – 202017006 and 202017011 – 202017014 (Issued October 16, 2019; Released April 24, 2020)**

Proposed changes will not ungrandfather pre-October 8, 1990 buy-sell agreement for purposes of Section 2703

Prior to October 8, 1990, the effective date of Section 2703 as part of Chapter 14, certain shareholders of a company entered into a Stock Redemption and Buy-Sell Agreement (the "Agreement"). At the time, the Company had one class of common stock and one class of preferred stock.

Under the Agreement, the shares of stock could be transferred to lineal descendants of A and B and to trusts for the benefit of the spouse of a shareholder as long as the ultimate beneficiary of the trusts were lineal descendants of husband and wife, A and B. The Company had a right of first refusal if a shareholder or transferee of shares from a shareholder wished to encumber or dispose of shares in the Company (other than to lineal descendants or in trusts for the spouses of shareholders). The price was determined either by a formula or a price fixed by the shareholders. The shareholders of the Company were A and B, their three daughters, a trust for the benefit of the three daughters (the "Daughter Trust") and trusts for the individual benefit of each of seven grandchildren and of which each grandchild was the sole beneficiary (the "Grandchild's Trust"). Each Grandchild's Trust terminated when the grandchild reached age 21.

After October 8, 1990, A and B died, shares of stock were distributed to grandchildren when a grandchild's trust terminated, the company changed its name and made administrative changes such as the number of members of the Board of Directors, the first daughter created six GST Trusts funded with shares of stock for the initial benefit of her six living nieces and nephews, the second daughter created separate GST trusts for each of her three children to be funded with Company stock after the receipt of a favorable letter ruling, and the third daughter created separate GST trusts for each of her three children to be funded with Company stock after the receipt of a favorable letter ruling.

The Company proposed to cancel all shares of the common stock held in treasury and to recapitalize the Company so the newly issued voting stock would be primarily held by shareholders actively involved in the business and nonvoting stock would be held by the other shareholders. Subsequently, nonvoting stock would be transferred to the Grandchildren's trusts.

The following rulings were sought in this series of letter rulings:

1. None of the transfers of the shares of the stock in the company after October 8, 1990 constituted substantial modifications to the agreement within the meaning of Treas. and the agreement would continue to be grandfathered for purposes of Chapter 14.

2. None of the amendments to the articles would subject the agreement to Chapter 14.

3. The proposed Plan of Recapitalization would not subject the agreement to Chapter 14.

4. The proposed transfers of non-voting common stock to the Grandchildren's Trusts would not subject the agreement to Chapter 14.

Section 2703 provides that buy-sell agreements created after October 8, 1990 must provide for the use of a value that reflects the fair market value of the property for purposes of the estate, gift and generation transfer taxes. Otherwise, the value provided for in the buy-sell agreement will be ignored. A pre – October 8, 1990 agreement is grandfathered from Section 2703 if it is not substantially modified after that date.

The IRS first ruled that none of the transfers of Company Stock would constitute a substantial modification and the Agreement would continue to be grandfathered. An agreement will be treated as having been substantially modified if a family member assigned to a generation lower than those of the parties already subject to the agreement under Treas. Reg. § 25-2703-1(c). Here, the family members to whom transfers were or would be made were with the generation assignments of current shareholders.

The IRS next ruled that none of the modifications of the bylaws and articles would constitute substantial modifications under Treas. Reg. § 25-2703-1(c). The Service also ruled that that the Plan of Recapitalization into voting and nonvoting stock would not constitute substantial modifications under Treas. Reg. § 25-2703-1(c). Finally, the Service ruled that the proposed transfers of non-voting common stock to the Grandchildren's Trusts would not constitute substantial modifications under Treas. Reg. § 25-2703-1(c).

Consequently, the Agreement would continue to be grandfathered from any application of Section 2703.

FIDUCIARY INCOME TAX

39. Proposed Regulations on Section 67(g) (May 7, 2020)

IRS issues proposed regulations on effect of Section 67(g) on certain deductions for estates and nongrantor trusts

In Notice 2018-61, 2018 -31 IRB (July 13, 2018), the Treasury Department and the IRS announced that they intended to issue regulations on the impact of new Section 67(g) of the Internal Revenue Code of 1986 on certain deductions for estates and nongrantor trusts. Section 67(g) was added to the Code by the 2017 Tax Act and suspended temporarily miscellaneous itemized deductions for tax years beginning on or after January 1, 2018 through December 31, 2025. Proposed regulations on Section 67(g) were issued almost two years after the issuance of Notice 2018-61 on May 7, 2020.

The proposed regulations make clear that certain deductions for irrevocable nongrantor trusts and estate are still available. Administrative expenses such as trustee's fees and appraisal fees can be deducted. Also certain expenses giving rise to excess deductions can be passed on to beneficiaries upon the termination of a trust or estate. While separating the deductions will require more work, this will allow beneficiaries to use some of excess deductions on their income tax returns to reduce their adjusted gross income.

Under Section 67(e) of the Code, the adjusted gross income of an estate or nongrantor trust is computed in the same manner as that of an individual, with two exceptions. Section 67(e)(1) permits an estate or nongrantor trust to deduct in computing adjusted gross income the costs incurred in connection with the administration of the estate or trust that would not have been incurred if the property were not held in the estate or trust. Such expenses generally include, for example, fiduciary compensation and court accounting costs. Section 67(e)(2) provides an exception for deductions allowable under Section 642(b) (relating to the personal exemption of an estate or nongrantor trust), Section 651 (relating to distributions of income to beneficiaries of simple trusts), and Section 661 (relating to distributions of income and principal to beneficiaries of complex trusts).

Tax practitioners expressed concern that Section 67(g) might inadvertently eliminate the deduction for costs of estate and trust administration. Practitioners also requested guidance on whether the suspension of miscellaneous itemized deductions prohibits trust and estate beneficiaries from deducting on their individual returns the excess deductions of the trust or estate incurred during the trust's or estate's final taxable year. The proposed regulations clarify that the costs of trust or estate administration are not miscellaneous itemized deductions suspended by Section 67(g).

The proposed regulations also address the impact of Section 67(g) on the ability of beneficiaries to deduct an estate's or trust's excess deductions upon termination of the estate or trust. On the termination of a nongrantor trust or estate, Section 642(h) of the Code allows the beneficiaries succeeding to the property of the nongrantor trust or estate to deduct the trust's or estate's unused net operating loss carryovers under Section 172 of the Code and unused capital loss carryovers under Section 1212 of the Code. If an estate or nongrantor trust has deductions (other than deductions for personal exemptions or charitable contributions) in excess of gross income in its final taxable year, then Section 642(h) allows the beneficiaries succeeding to the property of the estate or trust to deduct such excess on their individual returns. Capital loss carryovers and net operating loss carryovers are taken into account in calculating adjusted gross income and are not miscellaneous itemized deductions. Section 67(g) therefore does not affect the ability of a beneficiary to make use of a capital loss carryover or net operating loss carryover received from an estate or nongrantor trust.

The excess deductions of an estate or nongrantor trust, however, are allowable only in computing taxable income and are not covered by an exception from miscellaneous itemized deductions in Section 67(b). Absent guidance to the contrary, the excess deductions of an estate or nongrantor trust are now disallowed by Section 67(g) for taxable years beginning after December 31, 2017, and before January 1, 2026. The inability of beneficiaries to claim excess deductions may create unwelcome and unanticipated consequences. For example, it could artificially affect timing of distributions, delay closing of estates, and create incongruity in the treatment of administration expenses — permitting them as deductions to an estate or trust but denying them when passed-out to beneficiaries.

The proposed regulations preserve the tax character of the three categories of expenses rather that grouping all non-Section 67(e) expenses together, to allow for such expenses to be separately stated and to facilitate reporting it to beneficiaries. 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 proposed regulations also require fiduciaries to identify deductions that may be limited when claimed by a beneficiary.

The proposed regulations state that the principles under Treas. Reg. § 1.652(b)-3 will be used to allocate each deductible item among the classes of income in the year of termination in order to determine the character and amount of the excess deductions under Section 642(h)(2). Any remaining deductions that are not directly attributable to a specific class of income and any deductions that exceed the amount of directly attributable income, may be allocated to any item of income, but a portion must be allocated to tax-exempt income.

Existing regulations under Treas. Reg. § 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 of the trust as to the amount with respect to which the beneficiary qualifies. The proposed regulations do not change this method of allocation.

40. **Letter Ruling 202022002 (Issued February 25, 2020; Released May 29, 2020)**

Third party treated as grantor of irrevocable trust

Grantors created an irrevocable trust, which was designated as Trust 1, for the benefit of their children and grandchildren, and transferred otherwise unidentified Shares to the irrevocable trust. Then Trust 1 was divided into separate trusts for each of grantor's children and grandchildren. The Trust 1 indenture prohibited the distribution of the Shares but allowed for the distribution of the proceeds from the sale of the Shares.

Subsequently, Trust 1 contributed all of its Shares to a limited liability company in exchange for membership interests in the limited liability company. The restrictions on the distribution of Shares also applied to the distribution of the LLC interests. Then, Trust 1 distributed a portion of its LLC interests to a Subtrust of which A was the sole beneficiary. The LLC's assets included cash and the Shares. A could withdraw all of Subtrust's assets, except the LLC interests, when A reached age 40. Subsequently, A withdrew all of the Subtrust's assets except the LLC interests. Later, the trustees of the Subtrust agreed to sell a portion of the LLC interests held in the Subtrust to a new trust, Trust 2, in exchange for cash and a promissory note. Trust 2 was a grantor trust with respect to A. A also had the authority to withdraw the cash and the promissory note from the Subtrust after the proposed sale.

The IRS concluded that because A had the power exercisable by herself to vest the proceeds from the sale of the Subtrust's LLC interests in herself and because those proceeds were the only assets of the Subtrust after the sale to Trust 2, A would be treated as the grantor of the Subtrust for fiduciary income tax purposes under Section 678. As a result, the transfer of the LLC interests to Trust 2 was not treated as a sale for federal income tax purposes because Trust 2 and the Subtrust were both treated as wholly owned by A for fiduciary income tax purposes.

ASSET PROTECTION

41. Campbell v. Commissioner, T.C. Memo 2019-4

U.S. Tax Court respected a foreign asset protection trust and held that the IRS could not consider the trust assets in determining the taxpayer's assets for purposes of collecting a tax liability

In 2002 and while a resident of Connecticut, John F. Campbell filed his personal income tax return for 2001. Campbell's return reported taxable income of just over $20,000 and a tax liability of about $60,000.

Near the end of 2002, Campbell and his family moved to the island of St. Thomas in the U.S. Virgin Islands. In 2004, while a resident of St. Thomas, Campbell created the First Aeolian Islands Trust pursuant to the law of Nevis, West Indies. Campbell named Meridian Trust Co. Ltd. as the initial trustee, although the trust protector, who held the power to remove and replace the trustee, later replaced Meridian Trust with Southpac Trust Nevis Ltd. The trust was structured as an irrevocable foreign asset protection trust. Campbell funded the trust with $5 million in cash and marketable securities.

At the time he created the trust, Campbell had a net worth of approximately $25 million. Campbell and members of his family could receive distributions from the trust in the sole discretion of the trustee, but Campbell never received any distributions of trust assets. Campbell could not appoint or remove the trustee nor direct the trustee to make any distributions or investments. The trust was a grantor trust as to Campbell for federal income tax purposes.

During 2001, Campbell had engaged in a tax shelter transaction (a custom adjustable-rate debt structure, or CARDS transaction). In 2004, the IRS initiated an examination of Campbell's 2001 income tax return. In 2006, Campbell made a $27 million investment in the "GO-Zone" initiative in the U.S. Gulf Coast Region. Campbell's investments consisted of commercial and residential real estate. In 2009, about half of the residential real estate was declared uninhabitable because it had been built using toxic drywall.

As a result of the drywall issues and the 2008 housing crash, Campbell's investments generated an approximately $10.5 million net operating loss. Through a series of transactions in 2009, Antilles Offshore Investors Ltd., which was a subsidiary of Antilles Master Fund, a foreign entity the trust created, loaned money to one of Campbell's business entities in the Gulf Coast Region. Because of personal guarantees on a number of other loans, Campbell effectively became insolvent by 2010.

In 2007, the IRS completed its examination of Campbell's 2001 return and issued a notice of deficiency for approximately $13.9 million. Campbell filed a petition with the U.S. Tax Court contesting the deficiency. Campbell and the IRS ultimately settled and Campbell was able to deduct his net operating loss carryback against his 2001 deficiency. The settlement left Campbell with an approximately $1 million deficiency and a $100,000 accuracy-related penalty.

In 2010, the IRS issued a notice of intent to levy against Campbell's assets, to which Campbell objected. In 2012, Campbell filed a petition with the Tax Court seeking to bar the levy. The Tax Court remanded the petition to the IRS Appeals Office.

At the Appeals Office hearings, Campbell submitted an offer in compromise on the basis of doubt of collectability and offered to settle all his outstanding debts for $12,603. The IRS stated that Campbell was ineligible for doubt of collectability status because he had "net realizable equity" of approximately $1.5 million in the trust. As negotiations collapsed, the IRS increased Campbell's reasonable collection potential to more than $19.5 million by including the $5 million Campbell placed in the trust as dissipated assets. In 2018, the IRS formally rejected Campbell's offer in compromise. Campbell appealed to the Tax Court.

The Tax Court reviews the IRS' administrative determinations for abuse of discretion. Section 7122(a) of the Internal Revenue Code permits the IRS to compromise civil cases arising under the Internal Revenue Code. Regulations promulgated under Section 7122 list three grounds for compromise: (1) doubt as to liability, (2) doubt as to collectability and (3) promotion of effective tax administration.

Doubt as to collectability exists when the taxpayer's income and assets are less than the amount of the tax liability. Doubt as to collectability is assessed on the basis of the taxpayer's reasonable collection potential. A taxpayer's reasonable collection potential is based on (1) assets, including dissipated assets; (2) future income; (3) assets collectible from third parties; and (4) assets available to the taxpayer but beyond the reach of the government.

Dissipated assets include assets that the taxpayer sold, transferred, encumbered or disposed of in an attempt to avoid the tax liability after the tax was assessed or for up to a period of six months before the assessment. According to the U.S. Supreme Court, assets collectible from third parties include assets that a third party is holding as a nominee or alter ego of the taxpayer.

The "nominee theory" focuses on whether the taxpayer is the true beneficial owner of the property. The "alter ego" theory focuses on whether the taxpayer has pierced the corporate veil. According to the Supreme Court, both theories look first at what rights the taxpayer has in the property under state law and then at federal tax law to determine whether the taxpayer's rights constitute a property right for collectability purposes.

The Tax Court ultimately found that the IRS abused its discretion in considering the trust an asset for purposes of Campbell's reasonable collection potential. The Tax Court held that the $5 million Campbell placed in the trust were not dissipated assets. Campbell placed the assets in the trust in 2002, three years before the IRS informed Campbell his 2001 return was under examination, six years before the assessment of the deficiency and 10 years before his offer in compromise. Accordingly, the transfer to the trust was beyond the permissible period for inclusion as a dissipated asset. Furthermore, even if the transfer to the trust took place within the permitted periods, Campbell had a net worth of over $25 million at the time he funded the trust.

The Tax Court also held that the trust was not considered an asset Campbell could collect from a third party. In making this finding, the Tax Court focused on two facts. First, Campbell had no control over the trustee and could not force the trustee to make distributions or investments. Second, Connecticut law, which governed Campbell's state law rights in the trust at the time the tax deficiency arose in 2001, did not have a developed body of law as to whether Campbell had any property rights in a foreign asset protection trust. Because the IRS could not defend its position that Campbell had a property right in the trust under state law, the Tax Court held that the IRS' position that the trust was available to Campbell was an abuse of discretion.

Finally, because Campbell did not have sufficient control over the trustee or the trust to compel a distribution or investment, the Tax Court held that the trust was not an asset of Campbell's beyond the reach of the government. The Tax Court made this finding despite the IRS' argument that Campbell had the de facto right to remove and replace the trustee through the trust protector and that the trustee loaned money to Campbell's business at Campbell's effective direction.

This case demonstrates that the Tax Court will respect a properly structured foreign asset protection trust. Most reported decisions involving asset protection trusts have held that the transfers to the trusts were fraudulent transfers or voluntary conveyances. Recently, however, cases with facts favorable to grantors have resulted in findings that respect asset protection trusts. In this case, the Tax Court respected a foreign asset protection trust when the trustee was fully independent of the grantor, the grantor could not remove or replace the trustee, the trustee had total discretion over distributions and investments, the grantor created the trust while the grantor was solvent, and the grantor had received no distributions from the trust.

FIDUCIARY CASES

42. **Smith v. Szeyller, 31 Cal. App. 5th 450 (2019)**

A beneficiary who received notice but did not participate in litigation between another beneficiary and the trustees found herself with no recourse to object to the settlement reached between the litigating beneficiary and the trustees, even where the settlement agreement provided that a portion of the litigating beneficiary's legal fees be paid out of the non-participating beneficiary's trust share

Mr. and Mrs. Smith created a trust naming their five children as beneficiaries. At Mr. Smith's death, Mrs. Smith became the sole trustee of the trust. Mrs. Smith named her daughter, Joann, as her co-trustee, and Joann's husband, Edward, as her successor trustee. After Mrs. Smith's death, Joann and Edward served as co-trustees of the trust (the trustees).

One of Joann's brothers, Don, objected to an accounting the trustees provided and filed a verified petition questioning trust expenditures and gifts made to Joann and Edward from the trust before Mrs. Smith's death. Don's petition requested that the court freeze the trust assets, remove the trustees and pay Don's attorney's fees from the trust assets. The trustees agreed to freeze trust assets, make a distribution of $200,000 to each of the beneficiaries before trial and revised their accountings. The trustees petitioned the court for approval of their revised accountings. Don filed objections and a petition for financial elder abuse. The other three siblings — Donna (through her conservator), Dave and Dee — were all notified of the petitions but did not respond. Additionally, Don specifically asked Donna (through her conservator) if she wanted to join the litigation and she declined.

After three days of trial, the trustees advised that they had revised their accountings again to address Don's concerns. The trustees and Don then reached a settlement agreement that the court approved. The agreement provided, in part, for the payment of Don's attorney's fees from the trust assets. Donna (through her conservator) filed post-trial motions for a new trial and to vacate the judgment on the grounds that she had been denied due process and challenging the award of attorney's fees.

In general, the "American rule" requires successful litigants, including a beneficiary challenging the actions of a trustee, to pay their own attorney's fees. An exception to this rule is the "common fund doctrine," which permits the court to require that non-litigants who receive a pecuniary benefit as a result of the litigation bear a portion of the legal fees. The substantial benefit doctrine extends the common fund doctrine to permit a court to require passive parties who receive non-pecuniary benefits as a result of litigation to bear a portion of the legal fees.

On appeal, the California Court of Appeals affirmed the trial court's ruling and upheld the settlement agreement, including the award of attorney's fees from trust assets. The Court of Appeals rejected Donna's due process argument because Donna had been notified about the litigation and chose not to participate. Because Donna chose not to participate in the litigation, the California Court of Appeals determined that she was not entitled to additional notice regarding the proposed settlement agreement, which addressed matters already before the court. Additionally, the Court of Appeals found that the award of attorney's fees and the application of the substantial benefit doctrine were appropriate in this case because the non-participating beneficiaries received the benefit of more accurate trust accountings, refunds to the trust from the trustees and a stop to further inappropriate depletion of the trust assets by the trustees, all of which benefitted all of the beneficiaries, not just the litigating party.

The substantial benefit theory has rarely, if ever, been applied in the trust context before. Further application of the substantial benefit theory in the trust context may lead more disgruntled beneficiaries to act unilaterally to initiate litigation if there is a possibility to spread their legal fees amongst all the beneficiaries even without their consent. At the same time, beneficiaries who previously may have been disinclined to join in litigation may be more likely to do so based on this case. As Donna learned the hard way in this case, by failing to participate in the litigation, a beneficiary may lose her seat at the negotiating table and miss the chance to object to settlement terms with which she disagrees, such as payment of fees out of her trust share.

43. **<u>Matter of Fund for Encouragement of Self Reliance</u>, 440 P. 3d 30 (2019) (4th Dist., April 25, 2019)**

Where the terms of a charitable trust appointed multiple trustees and did not explicitly provide that the trustees could act alone, consent by all of the co-trustees was required to decant the trust, despite the reference in the decanting statute to "a Trustee," in the singular

The terms of a charitable trust appointed co-trustees. The trust did not include provisions giving any one trustee the ability to act unilaterally. When a dispute arose among the co-trustees, the 8th Judicial District Court, Clark County, Nevada, ordered that half of the property be decanted into a new trust with the same purpose as the original trust, but to be administered by only one of the original trustees, against the objection of the co-trustees. The co-trustees appealed on the grounds that consent of all of the co-trustees was required to decant the trust.

The Nevada decanting statute provides that "unless the terms of … [the] irrevocable trust provide otherwise, a trustee with discretion or authority to distribute trust income or principal to or for a beneficiary of the trust may exercise such discretion or authority by appointing the property subject to such discretion or authority in favor of a second trust as provided in this section." NRS 163.556(1). The term "trustee" is defined by NRS 163.500 to mean "a trustee, trustees, person or persons possessing a power or powers referred to in [the Charitable Trust Act]." The governor of Nevada amended that law on June 5, 2019, but not in a way that substantively changed the law relied on in this case.

The Nevada Supreme Court overruled the lower court and held that the decanting statute does not permit decanting of the trust without the consent of all of the trustees. In reaching its decision, the Nevada Supreme Court noted that, in relevant part, the trust provided that the "*Trustees* … may, in *their* discretion" manage trust property and income (emphasis added by the Nevada Supreme Court). Quoting Bogert's *Law of Trusts and Trustees*, the Nevada Supreme Court explained, "In the absence of statute or contrary direction in the trust instrument, the trustees are regarded as a unit."

Because neither the statutory definition of trustee, nor the terms of the trust contradicted that presumption, the Nevada Supreme Court found that the unanimous consent of all of the co-trustees was required to exercise a discretionary power, including the statutory decanting power. However, because the Nevada Supreme Court found consent from all of the co-trustees was required, they did not need to address the issue of whether the Nevada decanting statute even applies to charitable trusts.

This case is a reminder to practitioners to be deliberate in drafting and to be aware of statutory default rules regarding the ability or inability of trustees to take unilateral action.

44. <u>In re Deborah Dereede Living Trust dated December 18, 2013</u>, 2019 WL 1549157 (S.C. App. April 10, 2019)

A trustee's reasonable, good-faith departure from the express terms of a trust nevertheless constituted a breach of fiduciary duty

Courtney Feely Karp was the personal representative of the estate of her mother, Deborah Dereede (the decedent), and the successor trustee of the decedent's revocable trust agreement, which became irrevocable at the decedent's death. The decedent's revocable trust agreement provided that "as soon as practicable" after the decedent's death, the trustee should sell certain real property, discharge the mortgage secured by the property and distribute one-half of the net proceeds of sale to Karp's stepfather, Hugh Dereede.

Because she was also serving as personal representative of the decedent's estate, Karp believed that she could not sell the real property and distribute the proceeds until the time for creditor's claims against the estate expired. Hugh Dereede disagreed and brought an action in the applicable South Carolina Circuit Court. In response, Karp claimed Dereede violated a no-contest clause in the decedent's revocable trust by initiating the lawsuit. The Circuit Court ruled that Karp breached her fiduciary duties by failing to sell the real property and distribute the property to Dereede as soon as possible. Karp appealed.

A trustee is obligated to administer a trust in accordance with its express terms. In particular, a trustee must adhere strictly to express directions as to how and when to dispose of trust property. While personal representatives often must delay the distribution of assets until the personal representative determines that the estate has sufficient liquidity to satisfy all creditors' claims, that rule does not apply in the case of trustees. According to the Court of Appeals, a trustee breaches her fiduciary duties by failing to act in strict compliance with the terms of the trust agreement, even if the trustee does so reasonably and in good faith. Furthermore, according to the appellate court, a no-contest clause in a will or trust agreement cannot be enforced against an interested person who has probable cause to contest the validity of the document or the actions of the fiduciary.

The Court of Appeals upheld the Circuit Court's decision, finding that Karp breached her fiduciary duties by failing to take any action to sell the real estate within six months of the decedent's death.

The Court of Appeals also held that Dereede did not trigger the no-contest clause in the trust agreement because he had probable cause for bringing his action against Karp.

A trustee's bad faith nearly always constitutes a breach of fiduciary duty. This case is a reminder that even a trustee's reasonable, good-faith actions can still constitute a breach of trust when the trustee's actions violate the express terms of the trust.

45. <u>Gibbons v. Anderson</u>, 2019 Ark. App. 193 (April 3, 2019)

Arkansas Court of Appeals held that the arbitration provision in a trust agreement was unenforceable in a suit challenging the validity of the trust on grounds of undue influence

Woodrow W. Anderson Jr. executed a trust agreement on April 1, 2014, with himself as initial trustee, and his children, Woodrow Anderson III and Kandice Gibbons, as successor trustees. The trust provided that the trust would pay for the college educations of all grandchildren of the grantor up to $100,000 total, and no more than $25,000 each. Each grandchild was to receive a car, not to exceed $30,000, after completing one semester or two terms in college. The trust further provided that each grandchild was to receive $500 per month for expenses.

On Nov. 7, 2014, Woodrow Jr., Woodrow III and Gibbons executed the first amendment to the trust, making several significant changes to the terms of the trust. Woodrow Jr. was in poor health and under the influence of narcotics at the time. He died 17 days later.

On Jan. 4, 2017, Seth Anderson and Trevor Anderson, grandchildren of Woodrow Jr., filed a complaint for breach of trust, alleging that the amendment was executed as a result of undue influence and that the changes to the terms of the trust were not in the best interests of the beneficiaries. Specifically, the amendment gave the trustees the sole discretion to make distributions for education, and removed the specific provisions originally included. Seth and Trevor further alleged that the trustees had breached the trust and acted in bad faith by failing to provide $500 per month for expenses and a vehicle as set forth by the original terms of the trust.

The complaint sought to set aside the amendment, to remove the trustees, to appoint new trustees, to obtain an accounting of the trust, to restore any funds improperly distributed under the amendment and to impose a constructive trust against any property improperly removed from the trust. They also requested a judgement against the trustees and the trust for the value of the vehicles that should have been purchased, the payment of $500 per month that should have been paid pursuant to the trust, and to recover the amounts the trustees had expended on educational expenses.

The trustees filed a motion to dismiss, or in the alternative, to compel arbitration in accordance with the arbitration clauses contained in the trust and the amendment. Seth and Trevor filed a response to the motion, alleging that the arbitration clause in the trust did not purport to bind the beneficiaries, and the arbitration clause in the amendment was not valid because the grantor was not competent at the time of execution of the amendment.

The trial court held that the question went to the integrity of the amendment and whether the grantor was under undue influence at the time of execution of the amendment, and that was a question for the court to decide, not an arbitrator. The trial court denied the motion to compel arbitration. The trustees appealed.

Arkansas law is silent on whether a trust may contain any arbitration provision, and Arkansas has not enacted a law addressing the applicability of an arbitration clause to a dispute concerning the validity of a trust.

The Court of Appeals stated that the dispute concerned the testamentary capacity of the grantor and the validity of the trust and the amendment, and that where there is an allegation of undue influence or incompetency of the grantor, arbitration cannot determine the validity of the trust. The Court of Appeals held that the validity of the trust and the amendment were within the jurisdiction of the trial court, irrespective of the arbitration provisions contained in both.

In holding that the question of trust validity was one for the court rather than arbitration, the Court of Appeals looked to statutes enacted in Florida and Arizona concerning arbitration clauses in trusts, both of which exclude disputes over the validity of a trust from arbitration. The court also looked to case law in California, where in *McArthur v. McArthur*, 224 Cal. App. 4th, 651 (2014), the California Court of Appeals denied a motion to compel arbitration as to the validity of a trust where a trust instrument contained an arbitration clause, thus indirectly holding that the validity of a trust agreement is not subject to arbitration.

Because Seth and Trevor sought to set aside the amendment on grounds of undue influence, this constituted a challenge to the validity of the instrument and therefore not an issue to be resolved through arbitration.

Practitioners should be cognizant of the enforceability of arbitration clauses contained in testamentary instruments under applicable state law, as well as the applicability of such clauses to questions of validity of the instrument. State laws on this issue continue to develop, and practitioners should review applicable state law developments before advising clients on the validity and enforceability of arbitration clauses in this context.

46. **<u>In re Antonia Gualtieri Living Trust</u>, 2019 WL 1265167 (Mich. Ct. App. March 19, 2019)**

The court could not compel income distributions for payment of child support from a discretionary trust

Charles Anton is the beneficiary of the Antonia Gualtieri Living Trust. Petitioner Linda Anton sought to compel the trustees of the trust to make income payments to Charles so Linda might seek payment of child support and alimony arrearages from Charles. The trial court denied Linda's petition for distribution based on the fact that the trust is a purely discretionary trust, and that Linda was not entitled to compensation for the outstanding arrearages out of income distributions made to Charles from the trust. Linda appealed. On appeal, Linda and the trustees disagreed as to whether the trust at issue is a support or spendthrift trust, or a discretionary trust.

Pursuant to Michigan law, a discretionary trust allows the trustee to pay to the beneficiary as much of the income and principal as the trustee determines appropriate in his discretion, whereas a support trust allows a trustee to pay income and principal of the trust to the beneficiary for support, maintenance and welfare. A spendthrift trust provides that the beneficiary's interest shall not be transferable or subject to the claims of creditors. Creditors cannot compel the trustee of a discretionary trust to pay any part of income or principal in order that the creditors be paid.

The Court of Appeals held that the trust at issue is a discretionary trust, not a spendthrift trust, and therefore Linda cannot compel income distributions in order to obtain compensation for unpaid child support and alimony.

The terms of the trust provided that the trustee "in its sole and absolute discretion, shall apply to, or for the benefit of Charles Anton as much of the principal from the trust as the Trustee deems advisable for his education, health, maintenance, and support." Linda argued that the use of the term "shall" indicates mandatory distributions and therefore a support or spendthrift trust; the trustees argued that the use of the words "sole and absolute discretion" indicates a discretionary trust. The Court of Appeals held that while the term "shall" typically indicates a mandatory provision, the fact that the word "shall" is immediately preceded by the words "sole and absolute discretion" renders the trust discretionary.

The appellate court noted that, in attempting to construe a trust instrument, a court must ascertain and give effect to the settlor's intent. Here, the trust document states multiple times that the trustees are permitted to use their "sole and absolute discretion." The trust document also contains provisions providing guidelines for discretionary distributions, including: (1) conservative exercise of discretion, (2) consideration of other income and resources available to the beneficiary, and (3) preservation of assets as the primary purpose. Taken together, it was clear to the court that the trust does not mandate distributions to Charles, regardless of the use of the term "shall."

The Court of Appeals also noted that the Michigan Trust Code provides further support for the holding that the trust is discretionary, citing MCL 700.7102(D). That statutory provision defines "discretionary trust provision" to mean "a provision in a trust . . . that provides that the trustee has discretion . . . to determine," among other decisions, whether to make distributions, in what amount, when and to whom.

Lastly, the Court of Appeals addressed Linda's argument that public policy supports the argument that she be compensated for the arrearages via income distributions from the trust. The case law Linda cited in support of such argument applied specifically to spendthrift trusts. Because the trust at issue is a discretionary trust, the court rejected Linda's public policy argument.

State law determines the type of trust and the access rights of creditors. Practitioners should carefully review the distribution language of a trust and applicable state law to determine whether a trust is considered a discretionary trust, support trust or spendthrift trust, and be cognizant of the rights of creditors to access the assets of each such trust.

47. **<u>In the Matter of Cleopatra Cameron Gift Trust Dated May 26, 1998</u>**

The Supreme Court of South Dakota held that a California court's order requiring payment of child support from a trust was not entitled to full faith and credit, and that the father's child support rights were not enforceable against the trust

Cleopatra Cameron was the beneficiary of three trusts created by her father. Each trust contained spendthrift provisions that prohibited the trustee from making direct payments to Cleopatra's creditors. The trust provisions also granted the trustee sole discretion to make distributions from the trusts to Cleopatra. Cleopatra and Wells Fargo served as initial co-trustees of the trusts.

In 2005, Cleopatra married Christopher Pallanck. The couple lived in California with their two minor children until Christopher filed for divorce in Santa Barbara, California, in 2009. In March 2009, the California family court held Cleopatra and Wells Fargo in civil contempt for failure to pay Cleopatra's child support obligations from the trusts.

In July 2012, Cleopatra exercised her authority as trustee to transfer the trust situs from California to South Dakota. Wells Fargo and several subsequent corporate trustees resigned as co-trustees; ultimately, Trident Trust Company was appointed as successor co-trustee of the trusts.

In May 2017, Cleopatra petitioned the South Dakota trial court to declare that the trustees were prohibited from making her child support payments from the trusts. The trial court agreed. In addition, the trial court held that, although Cleopatra's obligation to pay child support was determined under California law, the enforcement of those obligations against the trusts was governed by South Dakota law. South Dakota does not recognize a public policy exception for the enforcement of child support orders against trusts. Therefore, the trial court held that the California court's order directing the trustees to make payments to Christopher for child support was not entitled to full faith and credit. Christopher appealed.

The full faith and credit clause of the U.S. Constitution provides that states must recognize other states' laws and judicial proceedings. However, the Constitution does not require states to adopt other states' practices regarding the manner and mechanisms for enforcing judgments.

The Supreme Court of South Dakota held that Christopher could not enforce Cleopatra's child support obligations against the trusts. Although California law allows a child support creditor to enforce claims against a trust, this is an enforcement mechanism rather than a substantive legal obligation. Therefore, the California court's order was not entitled to full faith and credit. Instead, South Dakota law governed the question of whether Christopher could compel support payments from the trusts.

Under South Dakota law, a creditor may not compel a trustee to use trust assets to pay the beneficiary's child support obligations. The Court noted that South Dakota's legislature specifically rejected provisions in the Third Restatement of Trusts that would allow a creditor to enforce a beneficiary's child support obligations against a trust.

Trustees often use their authority to transfer the situs of a trust to another jurisdiction to avail themselves of the new forum state's favorable laws. For example, a trustee might transfer the trust's situs to a state that allows the trustee to decant to a new trust. In this case, Cleopatra effectively used her authority to move the trusts' situs to South Dakota, which has more trust-friendly asset protection rules.

48. <u>Alexander v. Harris</u>, 2019 WL 2147281 (Fla. Dist. Ct. App. May 17, 2019)

A Florida appellate court held that a father's special needs trust, which contained a spendthrift provision, is subject to garnishment to pay his child support obligations

Clifford Harris was involved in a serious car accident as a minor. As part of the settlement, a special needs trust under 42 U.S.C. Section 1396p was created for Harris' sole benefit. Each month, $3,035 was paid to the trust. As of December 2016, the trust had a value of $141,997.

Under the terms of the trust, the trustee had sole discretion to distribute trust assets to Harris; Harris had no legal authority to compel distributions. The trust also contained a spendthrift provision. Spendthrift provisions generally prevent a beneficiary's creditors from seeking payment of the beneficiary's debts from the trust assets.

In May 2009, Christina Alexander obtained a child support order against Harris. After Harris failed to pay the child support obligations, Alexander asked the court to hold Harris in civil contempt. The trial court granted Alexander's first motion to hold Harris in contempt. Eventually, Harris once again failed to make child support payments, and his arrearages totaled $91,780. Alexander again moved to hold Harris in civil contempt. But the trial court denied Alexander's subsequent motions. Instead, the trial court found that Harris had no ability to pay the child support arrearages or his ongoing support obligations, despite the trust assets.

Alexander appealed the trial court's denial of her motion to hold Harris in civil contempt.

Under Florida law, discretionary distributions from a spendthrift trust are not protected from garnishment for the payment of child support, though Florida courts have found that enforcement against such a trust is a remedy of last resort.

The Florida District Court of Appeals held that Harris' trust could be garnished to enforce his child support obligations. The court found that Alexander had exhausted all other sources from which she might satisfy Harris' child support obligations. Furthermore, the court noted that although Florida law has long recognized the validity of spendthrift trusts, the state's public policy gives primacy to enforcing child support orders. Therefore, the court held that Alexander was entitled to enforce Harris' child support obligations against the trust.

Trusts often contain spendthrift provisions that are intended to protect the trust assets from the beneficiary's creditors. Those provisions are often valid when properly drafted. However, state law may create exceptions under which a creditor may enforce the debt against the trust. Child support obligations are often enforceable even against trusts with spendthrift provisions.

49. **Tangwall v. Wacker, 2019 WL 4746742 (Montana September 30, 2019)**

Vexatious litigant's attempts to evade collection through fraudulent transfers to self-settled domestic asset protection trust were denied

Donald Tangwall, for himself and as trustee of the Toni 1 Trust, filed several lawsuits against William and Barbara Wacker in Montana state court, which resulted in a Montana state district court's judgment in favor of the Wackers. Before the issuance of the last of the default judgments in favor of the Wackers, Toni Bertran and Barbara Tangwall transferred parcels of real property to an Alaska self-settled domestic asset protection trust, the Toni 1 Trust. The Montana district court held that the members of the Tangwall family had fraudulently transferred property to the Toni 1 Trust, and the court rescinded the transfer.

Donald Tangwall, as trustee of the Toni 1 Trust, filed a complaint on behalf of the trust asking the U.S. District Court to reverse the state district court's judgment. The Wackers then filed a motion to declare that Tangwall was a vexatious litigant.

The court outlined many of the cases filed by Tangwall over the years, illustrating his pattern of vexatious *pro se* litigation. The court highlighted Tangwall's 20-year history of filing frivolous and patently meritless lawsuits, and noted in detail Tangwall's bad faith, his filings' lack of clarity or basis in law or fact, his frequent failures to attend hearings or respond to motions, his incomplete and unsupported briefs, and his attempt to represent corporate entities as an unlicensed attorney.

Pursuant to 28 U.S.C. § 1651(a), the court may impose filing restrictions on abusive litigants. However, before imposing a filing restriction, the court must: (1) give litigants notice and opportunity to oppose the order before it is entered; (2) compile an adequate record for appellate review, including a listing of all the cases and motions that led the district court to conclude that a vexatious litigant order was needed; (3) make substantive findings of frivolousness or harassment; and (4) tailor the order narrowly so as "to closely fit the specific vice encountered."

The U.S. District Court granted the Wackers' motion to declare Tangwall a vexatious litigant, finding that the Wackers had thoroughly documented Tangwall's history of vexatious litigation. The court noted that Tangwall's litigation activity has spanned 20 years and numerous state and federal venues, that he has been declared a vexatious litigant in four other jurisdictions, and that three such rulings stem directly from Tangwall's litigation against the Wackers over the course of eight years.

Tangwall's history of litigation involved frequent actions on behalf of trusts, corporate entities and individuals, though he did not have a law license. His actions demonstrated a belief that he could fraudulently transfer assets to a trust and protect them from actions for recovery so long as he sufficiently badgered the opposing parties with repeated meritless filings, forcing them to back down or settle. While noting that Tangwall has a right to seek redress with courts, the U.S. District Court found his filings to be numerous and redundant, and to commonly lack any basis in fact or law. The court found he acted fraudulently and in bad faith, and that he harasses his opponents, in particular, the Wackers.

Lastly, in holding that Tangwall was a vexatious litigant, the court ordered that Tangwall must obtain preapproval before filing any further documents in the case at issue and any new complaints against the Wackers or their attorney. In addition, the court extended the limitation to other entities and individuals acting under Tangwall's direction, to address Tangwall's habit of ghost-writing complaints and other documents on behalf of legal entities and other individuals.

50. **Blech v. Blech, 38 Cal.App.5th 941 (2019)**

In California, creditors may request trust assets be made payable directly to the creditor even from a spendthrift trust once the amount to be distributed to a beneficiary is determined

Richard Blech is the beneficiary of a spendthrift trust his father created. The trust provides for annual distributions to Richard of the entire trust principal over the course of 10 years in non-discretionary predetermined amounts. The trust contains a spendthrift provision that states, in part, "[a]ll of the income and principal [of the] Trust shall be transferable, payable and deliverable only to [Richard] at the time [Richard] is entitled to take under the terms of [the] Trust."

Richard owed money to his siblings as a result of a settlement agreement he entered into with them. The siblings obtained money judgments against Richard and the probate court ordered the trustee of the trust to pay 25 percent of future trust distributions directly to the siblings, until their judgments were satisfied, pursuant to Section 15306.5 of the California Probate Code. Subsequently, the siblings and a third-party creditor filed petitions to enforce their money judgments against the remaining 75 percent of Richard's distributions, pursuant to section 15301(b) of the California Probate Code.

The court heard arguments on the matter three days before a scheduled distribution to Richard. After argument, the court ordered the trustee of the trust to proceed with payment of the 25 percent to the creditors on the scheduled distribution date but to retain the remaining 75 percent of the distribution in the trust until the court gave its ruling. Six days after the scheduled distribution, the court ruled in favor of the creditors. Richard appealed.

California law generally holds that a beneficiary's interest in a spendthrift trust is not subject to enforcement of a money order until payment is made to the beneficiary. (See Sec. 15300 and 15301 of the California Probate Code.) However, 15306.5 of the California Probate Code permits creditors to obtain a court order directing the trustee to pay up to 25 percent of a beneficiary's future trust interest directly to such creditor until the creditor's judgment is satisfied, provided such funds are not necessary for the support of the beneficiary and his or her dependents. If there is more than one creditor proceeding against the trust under 15306.5, the aggregate amount payable directly to creditors from the trust cannot exceed 25 percent of future distributions.

In addition to this provision, Section 15301(b) provides that "after an amount of principal has become payable to the beneficiary under the trust instrument, upon petition to the court … by a judgment creditor, the court may make an order directing the trustee to satisfy the money judgment out of that principal amount." In *Carmack v. Reynolds*, 2 Cal.5th 844 (2017), the California Supreme Court construed that provision to mean that creditors may reach principal already set up to be distributed to a beneficiary despite a spendthrift provision.

On appeal, the Court of Appeals of California for the 5th Circuit affirmed the probate court's decision and rejected all four of Richard's arguments. The court of appeals rejected Richard's argument that 15301(b) bars a creditor from *filing* a petition to enforce a judgment before a trust distribution is due and payable based on the plain language of the statute.

The court of appeals explained that if Richard's interpretation of the statute was correct and creditors were barred from filing a petition until after the distribution is paid to the beneficiary, there would be no window in which the remedy provided in 15301(b) of the California Probate Code could be utilized by creditors. Further the court of appeals ruled Richard's interpretation of the trust as requiring the trustee to make all payments directly to Richard as factually inaccurate because the trust left the receipt of payment to the discretion of the trustees.

Additionally, the court of appeals rejected Richard's argument that the probate court's decision should be overturned because it failed to consider what portion of the distribution should be unreachable by creditors because it was necessary to support Richard and Richard's dependents. The court of appeals determined the trust was not a support trust because the distributions of income and principal were mandatory and based on factors other than Richard's education and support. Accordingly, assessment of Richard's needs and other available resources was not a necessary consideration for the probate court. The court of appeals did note that the trust included language that the spendthrift clause "shall not restrict … the Trustee to use and disburse funds for the support maintenance, health and education of [Richard]." Still, the court of appeals was not persuaded that such language converted the trust to a support trust where its primary purpose was clearly nondiscretionary distributions of principal over a set term.

Finally, the court of appeals held that the probate court was within its discretion to release a written opinion rather than rule from the bench and to order the trustee to withhold Richard's distribution until such written opinion could be finalized.

51. <u>In re Ignacio G.</u>, 2019 WL 2376184, 2019 Tex. App. LEXIS 4648 (Tex. App. – Texarkana, June 6, 2019)

Summary judgment on how to interpret a trust was inappropriate where the intent of the settlors was not shown by sufficiently clear and convincing evidence

A husband and wife created a revocable trust, which named their daughter, Esperanza, as trustee. In addition to Esperanza, the husband and wife had a son, Ignacio. The wife had a daughter, Edna, prior to meeting her husband. The husband adopted Edna. The trust agreement defined "children" as Esperanza and Ignacio specifically, and the summary attached to the trust described the trust assets as passing in equal shares to Esperanza and Ignacio after the deaths of the husband and wife. Descendants were defined in the trust to include adopted persons. The term "children" did not appear in the trust except in the identification paragraph. Edna did not appear anywhere in the trust or the summary.

The trust provided that after the death of the surviving grantor, "all of the remaining trust property shall be distributed to the Grantor's [___________]. If none of the Grantors' descendants survives the surviving Grantor, one-half of the property of the trust … shall be distributed to the Husband's heirs and the other half … to the Wife's heirs."

After the husband and wife's deaths, Esperanza, as trustee, filed a petition for declaratory judgment in Travis County asking the probate court to fill in the blank in the document with the word "descendants" and to determine whether Edna was a beneficiary of the trust. The attorney who drafted the trust testified that although he did not remember husband and wife personally, he assumed, based on the trust summary and the clear definition of "children," that Edna was not an intended beneficiary of the trust. The probate court granted Esperanza's request for summary judgment, reformed all of the relevant trust termination provisions to provide for distribution of trust assets to the "children" rather than "descendants" and ruled that Edna was not a child and thus not a beneficiary of the trust. Edna appealed.

In construing a will, the court focuses on the testator's intent and Texas applies the same rules to interpreting a trust. In Texas, the meaning of a trust is a question of law when there is no ambiguity as to its terms. However, when the trust instrument's language is uncertain or reasonably susceptible to more than one meaning, the trust is deemed ambiguous such that its interpretation presents fact issues, which precludes summary judgment. Alternatively, Texas Property Code Section 112.054 provides that a court may order modification of terms of an unambiguous trust if such reformation is necessary to correct a scrivener's error and enact the settlor's intent as established by clear and convincing evidence.

The Court of Appeals of Texas overturned the trial court's award of summary judgment and remanded the case, ruling that there were genuine issues of material fact that precluded summary judgment. The Court of Appeals explained that the trial court must not have found the terms of the trust to be ambiguous, because otherwise the law would have precluded summary judgment. Accordingly, the Court of Appeals reasoned, the trial court must have been operating under the theory of a scrivener's error, which would permit summary judgment to reform the trust if the settlor's intent was shown by clear and convincing evidence as permitted by Texas Property Code Section 112.054. This section of the code did not exist when the trust was created, but the Court of Appeals reasoned that it was a codification of common law which did exist at the time of the creation of the trust and was therefore applicable.

The Court of Appeals found that under that standard, the trial court should not have issued summary judgment. The Court of Appeals explained that although the trust contained multiple scrivener's errors, the evidence presented was insufficient to determine the settlor's clear and convincing intent as a matter of law. For example, one of the scrivener's errors was a mistake in fact that the settlors had only two children, when in fact they had three, and the evidence reviewed in the light most favorable to Edna (as required on appeal of summary judgment against her) could mean that the error was not in failing to use the word "children" instead of "descendants" but instead failing to include Edna in the definition of the settlor's children. Therefore, there was a genuine issue of fact to be determined by the trier of facts before the trust could be reformed.

On Aug. 21, 2019, Ignacio and Esperanza filed a petition for review with the Supreme Court of Texas alleging that the Court of Appeals relied on the wrong standard of proof. As of this publication, the Supreme Court of Texas has not issued a ruling or indicated whether it intends to review the case.

For drafters, this case is another good reminder of the importance of careful drafting and review. The drafting attorney here explained that his paralegals drafted documents based on a form which he would then review. Here, his review was clearly insufficient as there was a least one blank left in the document, and the document summary did not necessarily match the terms of the trust. This is also an example of why it is helpful to specifically exclude children or other beneficiaries a client wishes to disinherit rather than relying on their omission to imply the client's intent. For trustees, this case demonstrates the importance of reading and analyzing the exact terms of the trust rather than relying on a summary of the provisions, even if generated by the drafting attorney.

52. **Levitan v. Rosen, 95 Mass. App. Ct. 248, 124 N.E. 3d 148 (2019)**

Interest in an irrevocable spendthrift trust created by a third party was deemed part of the marital estate to be considered in the division of property during a divorce, where the wife was the sole trust beneficiary

Upon his death, a father created a lifetime trust, governed by Florida law, for the benefit of his daughter. The daughter and an independent trustee served as co-trustees of the trust. The independent trustee had unlimited discretion to make distributions of income and principal to the daughter as the independent trustee deemed advisable. Additionally, the daughter had the right to withdraw five percent of the trust principal each year. The withdrawal provision specifically provided that if the daughter exercised her right of withdrawal, the trustee "shall make such distribution to [her]." The trust contained a spendthrift provision that specifically included a spouse as a potential creditor who could not reach trust assets. The daughter had a limited power of appointment at her death exercisable in favor of her father's descendants.

In the daughter's divorce, the trial court held that the annual right of withdrawal was includable in the marital estate to be divided in the divorce, but the remainder of the trust was not part of the marital estate because it was protected by the spendthrift clause. In dividing the marital property, the trial court included the value of the trust withdrawal right (but not the full value of the trust) in the daughter's share of the marital estate and also included the value of the withdrawal right in the daughter's income for purposes of awarding support. The daughter appealed.

In Massachusetts, a divorce court must divide the divorcing parties' property equitably; the size of each parties' estate for the purposes of equitable distribution includes all property to which a party holds title, however acquired. Further, in Massachusetts, a beneficial interest in a trust may, depending on the terms of the trust, be considered part of an individual beneficiary's estate even though the trustee, not the beneficiary, holds legal title. If a beneficial interest in a trust is not presently enforceable, Massachusetts courts have previously held that a divorcing beneficiary's interest should not be classified as property subject to equitable division but should be considered by the court under the statutory criteria of G.L. c. 208 § 34 as an "opportunity for each [spouse] for future acquisition of capital assets and income."

The Massachusetts Court of Appeals overturned the trial court's ruling, but in an unfortunate surprise for the daughter, did so on the basis that the full value of the trust, not just the value of the withdrawal right, should have been included in the marital estate, and remanded the case for further consideration of equitable division of property and appropriate support on the basis of the expanded marital estate. The Court of Appeals did not agree that only the value of the withdrawal right should be included in the daughter's income for purposes of determining support. The Court of Appeals reached this surprising result based on the fact that the daughter was the sole beneficiary of the trust and the settlor's primary intent was to provide for the daughter rather than subsequent generations. The Court of Appeals also stated that the annual right of withdrawal built a "degree of predictability" into the trust distributions, despite the fully discretionary nature of the trustee's distributions, which made the trust more than a "mere expectancy." The Court of Appeals held that because of the spendthrift provision, the trust property could be assigned only to the daughter in the equitable distribution of marital property, and that the trial court should determine on remand how to distribute the remaining marital estate in light of that assignment.

53. **In re Estate of Victor J. Mueller Irrevocable Trust Number One and Number Two, Stephanie Mueller v. Krohn, 2019 WL 3210857 (Wis. Ct. App. July 17, 2019)**

A trustee's report adequately disclosed the existence of a claim so as to shorten the statute of limitations period to one year for matters disclosed in the report

Victor Mueller established two separate, interrelated trusts during his lifetime, referred to as "trust one" and "trust two." Trust one contained two working farm properties. Stephanie is the sole income beneficiary **of** trust one. Upon her death, the residue will go to UW Foundation for scholarships. All of Victor's other assets were placed in trust two. Upon Victor's death, trust two provided for the payment of certain specific bequests, directed the trustee to liquidate the gemstones, and pour the remainder into trust one. Stephanie was bequeathed $500,000 and all of Victor's tangible personal property from trust two. Krohn was appointed as trustee of both trusts.

Following Victor's death, Krohn liquidated most of the assets of trust two and paid 50 percent of the specific bequests; Stephanie received $250,000. Krohn retained a reserve of assets to pay any additional estate taxes. Krohn continued Victor's contracts with farm operators and hunters who had farmed and hunted on the two properties in prior years. Stephanie received between $58,000 and $69,700 in the years 2014 through 2016. Stephanie filed a petition for judicial intervention, alleging that Krohn owed damages, had improperly charged a trustee's fee and should be removed as trustee for breach of fiduciary duty. Krohn and UW Foundation filed motions for summary judgment seeking to dismiss the petition. The Circuit Court dismissed Stephanie's claims on summary judgment and awarded attorneys' fees to Krohn and UW Foundation. Stephanie appealed.

A claim must be brought within one year of the date the beneficiary "was sent a report that adequately disclosed the existence of a potential claim for breach of trust," under Wisconsin law. "[A] report adequately discloses the existence of a potential claim for breach of trust if it provides sufficient information so that the beneficiary or representative knows of the potential claim or should have inquired into its existence."

The Court of Appeals addressed several issues and claims for breach of fiduciary duty. With respect to Krohn's statute of limitations defense, the court held that Krohn's acceptance of the trustee fee was not a breach of fiduciary duty. Both trust documents provided for "reasonable compensation," as agreed upon with the settlor or with the majority of living adult beneficiaries. Less than three months after Victor's death, Victor's attorney, Louise Andrew, sent Stephanie a "notice regarding trust" describing the trustee fee in detail. The notice specifically stated Krohn's compensation and included terms concerning an increase in compensation for 2014. Stephanie did not object to the compensation until she filed the petition underlying this appeal in April 2016. The court held that Stephanie's objection was barred by the statute of limitations and that, contrary to Stephanie's claim, it is not necessary that a report contain the contents of an annual report in order to trigger the one-year period.

The court held that Krohn did not otherwise breach her fiduciary duty by (1) continuing the farm contracts previously entered into by Victor with Krohn's brother and nephew, (2) employing her family members to clean and sell Victor's property, and (3) continuing the hunting leases granted by Victor to Krohn's family members. The court found that Stephanie had received a letter and a copy of the estate tax return, which adequately disclosed the existence of a potential claim for breach of trust with respect to the farming contracts and compensation of Krohn's family members helping with the estate. Therefore, her claims were time-barred by the one-year statute of limitations. As to the hunting leases, the agreements were entered into prior to Victor's death, and even so, the transaction was authorized by the terms of the trusts.

Trustees should take care to ensure that communications sent to a beneficiary contain sufficient information to constitute a "report" adequately disclosing the existence of a potential claim for breach of trust and any required statutory language so as to trigger the running of the applicable statute of limitations.

54. **Vander Boegh v. Bank of Oklahoma, N.A., 2019 WL 1495712 (Ky. Ct. App. Apr. 5, 2019)**

Beneficiaries' rights against a trustee are purely equitable, and a "letter of understanding" does not transform them into contract claims

This consolidated case involved two trusts, the Charles R. Jones Sr. inter vivos trust dated May 1, 1973, and the Eula Kathleen Jones testamentary trust dated Oct. 24, 1967, whose sole asset was a 100 percent ownership interest in the Three Rivers limestone quarry in Livingston County, Kentucky. Bank of Oklahoma, N.A., as the sole trustee of the trusts, had entered into a 99-year lease agreement with Martin Marietta Materials Inc., granting Martin Marietta the right to conduct mining operations at Three Rivers.

During an audit, an accounting firm engaged by the trustee uncovered an approximately $100,000 shortfall in royalties paid from Martin Marietta to Three Rivers over a 15-year period. After learning of the royalty shortfall, a group of beneficiaries from the Vander Boegh family, who collectively held approximately 3/16 of the beneficial interests in the trusts, requested that the trustee cease accepting royalty payments from Martin Marietta and issue Martin Marietta a notice of default pursuant to the lease. The remainder of the beneficiaries objected to the Vander Boeghs' request, prompting the trustee to file a declaratory judgment action seeking instructions from the McCraken Circuit Court. The Vander Boeghs filed numerous counterclaims against the trustee alleging breach of contract, breach of fiduciary duty and negligence.

The trial court issued a declaratory judgment directing the trustee to continue accepting royalty payments from Martin Marietta and to resolve the royalty dispute using all remedies available at law other than terminating the lease. The court then proceeded to trial on the Vander Boeghs' counterclaims. After trial, the court issued findings of fact and conclusions of law holding that (1) the Vander Boeghs' breach of contract and negligence claims failed because, subject to only minor exceptions, beneficiaries may bring only equitable actions against a trustee, and (2) the Vander Boeghs failed to establish any basis showing that the trustee breached its fiduciary duties. The trial court also awarded over $2 million in attorneys' fees and costs to the trustee. The Vander Boeghs appealed.

With only minimal exceptions, a beneficiary's rights against a trustee are purely equitable. A claim for breach of contract is an action at law and cannot be sustained by a beneficiary against a trustee. Furthermore, a beneficiary's allegations that a trustee acted negligently cannot transform an equitable action (breach of fiduciary duty) into an action at law, even if the applicable standard for a trustee's misconduct includes elements of a claim for negligence. A trustee is liable to the beneficiaries for breach of fiduciary duty only if the trustee failed to act reasonably (often referred to as the "duty of care" or the "duty of prudence") and in the best interests of the beneficiaries (often referred to as the "duty of loyalty"). The fact that some beneficiaries disagree with the trustee's decision, or that a different trustee would have acted differently, does not make a trustee liable for breach of fiduciary duty.

The Court of Appeals of Kentucky affirmed the trial court's judgment regarding the Vander Boeghs' counterclaims but remanded the trial court's award of attorneys' fees. The Vander Boeghs attempted to argue that a "letter of understanding" between the trustee and the beneficiaries amounted to a contract. The court disagreed, stating that the letter of understanding and all of the Vander Boeghs' counterclaims concerned how the trustee carried out its fiduciary duties. The court declined to hold the trustee liable for failing to follow the Vander Boeghs' request to terminate the lease because it recognized that the trustee had good reasons for not terminating the lease, including certain unusual market features about the lease and the loss of royalty payments while the trustee searched for a new operator for the quarry. Accordingly, the court affirmed the trial court's judgment that the trustee did not breach its fiduciary duties. The court, however, found that the trustee's legal invoices, which it submitted to support its award of attorneys' fees, contained too many redactions to provide sufficient factual support for the $2 million award. Accordingly, the court remanded the attorney fee issue back to the trial court.

The relationship between a trustee and beneficiaries arises from equity. Any efforts by a beneficiary to transform the relationship into a contractual one are not likely to find success. When facing a conflict between beneficiaries, a trustee acts prudently by asking a court for advice and guidance. A court likely will not find a trustee's past actions as a breach of fiduciary duty when those actions were consistent with the court's advice and guidance.

55. **<u>In the Matter of Estate of Cooney</u>, 454 P.3d 1190 (Montana December 24, 2019)**

Contract to make a will claim was not within the jurisdiction of the probate court

John Cooney II and Loriann Cooney divorced in 1980. As part of the divorce settlement, they agreed that the "ranch property" John II owned at the time of his death would be distributed to their daughters and any other children born after the divorce to John II, in equal shares. John II later had two more children. He died in 2015. His will left all of his real property to his son, John III.

John II's will was admitted to probate and his three daughters — Jonnie, Melissa and Jill — filed a motion to invalidate portions of the will that left the ranch property entirely to John III. The district court denied the motion. The daughters appealed, arguing that the court erred in determining that they could not enforce the divorce settlement agreement in the probate proceeding. They argued that the probate court had jurisdiction to administer the estate in accordance with the divorce settlement agreement because it involves John II's property and the issue of the rightful heirs and successor to the property.

A district court sitting in probate has limited jurisdiction and has only those special and limited powers expressly conferred by statute, including all subject matter relating to (a) estates of decedents, including construction of wills and determination of heirs and successors of decedents, and estates of protected persons; and (b) protection of minors and incapacitated persons.

On appeal, the court of appeals emphasized that the probate court has subject matter jurisdiction over estates of decedents and their administration, and that such is not an action at law nor a suit in equity. A probate court does not have jurisdiction to consider equitable matters.

Here, the daughters sought the enforcement of a contract to make a will. Montana law authorizes the use of succession contracts, or a written contract to dispose of a person's property by will, and the court noted that the divorce settlement agreement constituted such a succession contract. However, the remedy for a breach of contract is not a proceeding in probate court; rather, the equitable remedy of specific performance of the contract must be sought through an action in equity in a court of general jurisdiction. The claimant under a succession contract has a "right or interest in the estate, an equitable ownership therein." The court of appeals therefore upheld the district court's ruling, affirming that the probate court lacks jurisdiction to adjudicate a breach of contract claim related to a succession contract.

56. **<u>Waldron v. Susan R. Winking Trust,</u> 2019 WL 3024767, 2019 Tex. App. LEXIS 5867 (Tex. Ct. App. July 10, 2019)**

A Texas Court of Appeals held that a trustee's fiduciary duties are not discharged until the trustee has been replaced by a successor trustee

Susan R. Waldron was the beneficiary of a trust created by her parents. The current trustee resigned and the named successor trustee declined to serve. Pursuant to the trust agreement, if the named successor trustee failed or ceased to serve, a bank or a trust company was to be appointed as successor trustee. The trust agreement also provided that Susan could terminate a trustee, without cause, by written letter if both grantors were legally disabled or deceased.

Susan was unable to find a bank or trust company willing to serve as trustee and filed an application with the 241st Judicial District Court in Smith County, Texas, to appoint Raymond W. Cozby III as the successor trustee. Several days later, the district court approved Susan's request.

Less than a year later, Susan filed a *pro se* application asking the district court to appoint her as trustee. Susan alleged that Cozby refused to resign as trustee of the trust and as a result of his conduct, she would be forced to relocate to Tyler, Texas, "bereft, homeless, penniless and needlessly in danger." Cozby stated that he was willing to resign and had no objection to his removal upon the appointment of an appropriate successor trustee as provided in the trust agreement, or as otherwise determined by the court. He asked for a declaratory judgment and requested a finding that he complied with the trust's terms that he be removed or allowed to resign, that an appropriate successor trustee be appointed and that he be discharged from any further liability.

After a bench trial, the trial court found that the final accounting fairly and accurately set forth the trust's assets, liabilities, income and expenses, and the court approved it. The trial court further found that Cozby administered the trust in accordance with its terms and the applicable law and was not liable to Susan on any claims. The trial court also found that all expenses and professional fees Cozby paid or incurred were reasonable and necessary. The trial court appointed another individual as successor trustee with her term to begin 10 days after the judgment became final or all appeals exhausted, whichever was later.

Susan appealed, claiming that pursuant to the terms of the trust, she could terminate a trustee immediately, without cause, by written letter if both grantors were legally disabled or deceased. Accordingly, Susan argued that Cozby's resignation was complete the moment Cozby received her termination letter and he was not entitled to reimbursement for professional expenses incurred thereafter.

The terms of the trust prevail over any provision of the Texas Trust Code with certain exceptions that are not applicable in this case. However, where a trust agreement is silent, the Texas Trust Code controls. Pursuant to the Texas Trust Code, where a successor trustee is not selected under the terms of the trust instrument, a court may, and on the petition of an interested person shall, appoint a successor trustee. Moreover, the resigning trustee's fiduciary duties are not discharged until the trustee is replaced by a successor trustee.

The Court of Appeals of Texas affirmed the trial court's judgment. The trust agreement provided that Susan could terminate a trustee by letter and appoint a successor bank or trust company that was willing to serve, but no bank or trust company was willing to serve. Accordingly, the court of appeals held that Susan's attempt at removal by letter without naming a bank or trust company as successor was ineffective. Rather, the only procedure available to replace Cozby under these circumstances was by petition to the district court for the appointment of a trustee. The court of appeals held that although ready and willing to be replaced, Cozby, as trustee, was obligated to continue in the performance of his duties until replaced by a successor trustee, and thus was entitled to reimbursement for professional expenses incurred until he was properly replaced.

57. <u>Sibley v. Sibley</u>, 273 So. 3d 1062 (Fla. Ct. App. 2019)

A Florida appellate court held that an administratively dissolved private foundation is not in existence on the decedent's date of death for purposes of a bequest to that foundation, even when the private foundation is later reinstated

Curtiss F. Sibley executed a revocable trust under which his brother, Charles Sibley, was named trustee upon Curtiss' death. Pursuant to the terms of the trust, Curtiss left the residue of his estate to his private foundation, the Curtiss F. Sibley Charitable Foundation, if then in existence. If the private foundation was no longer in existence at Curtiss' death, Curtiss left the residue of his estate to the Fellowship House Foundation, a charitable organization in South Miami, Florida.

On Sept. 23, 2011, the private foundation was administratively dissolved. Three months later, Curtiss passed away. On July 9, 2012, approximately seven months after Curtiss' death, the private foundation was reinstated. However, Charles never opened a bank account for the private foundation, he did not file any paperwork for the private foundation with the IRS, and he never funded the private foundation, despite being in control of the trust funds.

In 2017, the Fellowship House Foundation filed a petition to reopen for subsequent administration, alleging that the private foundation was no longer in existence on the date of Curtiss' death and, therefore, pursuant to the trust agreement, the residuary trust estate should be distributed to Fellowship House.

The trial court concluded that the private foundation was not in existence at the time of Curtiss' death and ordered Charles to distribute the residuary trust assets to the Fellowship House. Charles appealed.

The Florida Statutes provides that an administratively dissolved corporation continues its corporate existence for the purpose of winding up and liquidating its business and affairs. A corporation administratively dissolved may apply for reinstatement, and if granted, the reinstatement relates back to the date of administrative dissolution. (See Fla. Stat. § 607.1422.) However, it is black letter law that in construing the terms of a trust, the court must ascertain and give effect to the settlor's intent.

The Florida District Court of Appeals held that the private foundation was no longer in existence at the time of Curtiss' death and the reinstatement of the private foundation's corporate status seven months later did not relate back to the date of death.

First, the Florida District Court of Appeals viewed the lack of funding, the lack of a bank account and the failure to file any IRS filings as evidence that the private foundation was non-functioning on the date of Curtiss' death. As the administratively dissolved foundation was non-functioning and could not take any actions at the moment of Curtiss' death except to complete its dissolution, the Florida District Court of Appeals held that the private foundation was no longer in existence at the time of Curtiss' death.

Second, the Florida District Court of Appeals held that the statute providing that the reinstatement of an administratively dissolved corporation relates back to the date of administrative dissolution is not applicable to the determination of whether the private foundation existed on the date of Curtiss' death. The Florida District Court of Appeals reasoned that to hold otherwise would frustrate Curtiss' intent to make his testamentary gift to the private foundation contingent on its existence on the date of his death because the foundation could possibly always be in existence so long as someone prospectively filed the necessary annual reports and paid the delinquent fees.

58. <u>Liebovich v. Tobin</u>, 2019 Cal. App. Unpub. LEXIS 5930

Remainder beneficiaries have standing to challenge a court order amending a revocable trust to partially disinherit these beneficiaries when one of the settlors was not given proper notice of the request for entry of such an order

In 1984, Theodore and Shirley Liebovich created the Liebovich 1984 Trust. Thereafter, they executed multiple amendments. Specifically, the sixth amendment provided that either spouse could modify or amend the trust during their lifetime if they acted jointly. Together with the sixth amendment, the spouses executed limited durable powers of attorney. Theodore went on to execute four more amendments to the trust, signing for himself and on the basis of the power of attorney for Shirley. These amendments effectively disinherited their grandchildren.

In 2013, Theodore filed a petition to modify the sixth amendment, to modify Shirley's power of attorney, and to validate the four additional amendments that were executed after the sixth amendment. Theodore served the petition on his children and grandchildren, but he executed a waiver of notice for Shirley as her attorney-in-fact. The probate court granted the petition and the order recited "all notices have been given as required by law."

After the death of both Theodore and Shirley, the grandchildren filed a motion to vacate the 2013 order as void for two reasons: (1) the grandchildren did not receive notice of the petition or the hearing, and (2) Shirley did not receive such notice. The probate court denied their motion on the grounds that the grandchildren were not entitled to mandatory notice since the trust was revocable and that any deficiency in serving Shirley was not applicable because she was not a party to the motion. The grandchildren appealed.

A party seeking to modify a trust under the California Probate Code must serve notice of hearing upon all trustees holding the power to revoke the trust. (See Cal Prob Code §17203.) A party seeking to modify a power of attorney must notify the principal. (See Cal Prob Code § 4544.) A void order is a "nullity" and it may be set aside not only by the parties and their privies, but also by a stranger to the action. (See *Mitchell v. Automobile Owners Indem. Underwriters* (1941) 19 Cal.2d 1, 7, 118 P.2d 815; and *Plaza Hollister Ltd Partnership v. County of San Benito* (1999) 72 Cal.App.4th 1, 15-16, 84 Cal. Rptr. 2d 715.) A stranger must point to some right or interest that would be affected.

The Court of Appeals of California granted the grandchildren's appeal, but only to the extent of holding the 2013 order was void for lack of notice to Shirley. The court of appeals held that the grandchildren were not entitled to notice regarding either the order modifying the sixth amendment or the order modifying the power of attorney. However, the court of appeals came to a different conclusion regarding notice to Shirley.

The court of appeals first addressed whether Shirley received proper notice. The court of appeals ruled Theodore lacked the power to execute the waiver of notice since the power of attorney did not grant Theodore the power to waive notice on Shirley's behalf. This conclusion meant the 2013 order was void.

Next, the court of appeals turned to whether the grandchildren, as strangers to the action, had standing to request that the 2013 order be declared void. In answering this question, the court of appeals noted that because the 2013 order dramatically reduced the grandchildren's inheritance, their rights were affected, and thus they did have standing to challenge the 2013 order and have it set aside, reinstating the inheritance they had lost.

59. **Matter of Troy S. Poe Trust, 2019 WL 4058593 (Tex. Ct. App. August 28, 2019)**

Texas appellate court determined that jury trials are available in trust modification actions to determine disputed facts

The settlor had two adult sons, Troy and Richard. The settlor established a trust for the benefit of Troy, which named himself, Richard and Anthony Bock, an accountant, as trustees. The trust contained a provision requiring the trustees to take actions unanimously. However, despite the terms, the settlor typically made decisions regarding distributions from the trust.

In September 2010, the trust entered into a care agreement with Angel Reyes Jr., who would be reimbursed for reasonable out-of-pocket expenses for Troy's care and maintenance. After the settlor's death, Bock looked at the history of distributions the settlor had regularly made and attempted to follow the same pattern. However, Richard insisted that Bock strictly comply with the trust terms demanding the trustees act jointly in taking actions. As a result, Bock and Richard disagreed on expenditures relating to Angel Reyes Jr.

Bock filed a petition to modify the unanimity requirement and add an extra trustee because of changed circumstances since the settlor's death. The petition asserted that the purposes of the trust had become impossible to fulfill, and modification would further trust purposes. The probate court set the matter for a bench trial despite Richard's request for a jury trial. The probate court entered a judgment modifying the trust in two ways. First, it appointed a family friend as successor trustee. Second, the order set a procedure for always ensuring there would be three trustees who could make decisions by majority vote. Richard appealed.

The Texas Trust Code, contained in the Texas Property Code, § 115.012, provides that normal civil procedure rules and statutes apply to trust actions. The Texas civil procedure rules and the Texas Constitution guarantee the right to a jury trial. Under Texas law, the right to a jury trial extends to disputed issues of fact in equitable, as well as legal proceedings. (See *San Jacinto Oil Co. v. Culberson*, 100 Tex. 462, 101 S.W. 197, 198 (1907).) As a general rule, where contested facts issues must be resolved before equitable relief can be determined, a party is entitled to have a jury resolve them. (See *Hill v. Shamoun & Norman, LLP*, 544 S.W.3d 724, 741 (Tex. 2018).)

The Court of Appeals of Texas set aside the order modifying the trust and remanded for a new trial.

Richard raised two issues for review. He claimed first that the probate court's modification was improper because it contravened the settlor's unambiguous intent, and second, that the probate court improperly denied him a jury trial. Richard argued that the questions of whether there were changed circumstances, or that the purpose of the trust had become impossible to fulfill, were for a jury to resolve. The court of appeals agreed with Richard in holding that whether a trust needed to be modified was a factual question that should have been decided by a jury upon proper jury demand.

Bock asserted three reasons why the right of a jury trial did not apply here: (1) Richard failed to pay the jury fee; (2) Richard, a trustee, had no justiciable interest in the terms of the trust; and (3) as a matter of law, the result would be the same.

The court of appeals rejected the jury fee argument because Bock failed to raise the issue in the probate court. In addition, the court of appeals rejected Bock's argument that Richard had no justiciable interest due to the fact that Bock had named Richard as a party, and that fact gave him a right to a jury trial. Last, the court of appeals held that questions as to the changed circumstances and impossibility of performance were disputed factual questions, and thus the refusal to grant a jury trial amounted to a harmful error.

Because the court remanded for a jury trial on these issues, it did not comment on Richard's first claim regarding the appropriateness of the probate court's modification order.

60. **<u>Matter of Sochurek</u>, 174 A.D.3d 908 (NY App. Div. 2019)**

Beneficiary claim against an executor for breach of fiduciary duty does not necessarily cause that beneficiary to violate an in terrorem clause

A decedent was survived by his wife, Anna Marie T. Sochurek, and his two daughters from a prior marriage, Lynn Ammirato and Lisa Birch. The decedent's will gave the wife a life estate in the decedent's interest in a limited liability company, including "all of the duties and responsibilities for the operation of [the company] as if she was the owner and member thereof." Upon the wife's death, her life estate would terminate and her interest would pass to the daughters in equal shares.

The will left the remainder of the decedent's estate to the wife outright, and made the wife the decedent's executor, with the power to "run, manage and direct any business of which [the decedent] may die possessed, temporarily or permanently, or to sell or otherwise dispose of such business and all the assets thereof upon any terms which [the executor] deem[s] advisable." The will contained an *in terrorem* clause that provided for the revocation of the interest of any beneficiary who "institute[s]… any proceedings to set aside, interfere with, or make null any provision of [the will] … or shall in any manner, directly or indirectly, consent the probate thereof."

After probating the will and being appointed as the executor, the wife sold the company, retaining for herself a 50 percent share of the sale proceeds. The wife and the daughters entered a standstill agreement whereby the wife agreed to hold the proceeds from the sale of the company in a segregated bank account until the wife and daughters agreed on the daughters' interests in the liquidated assets of the company as the remainder beneficiaries of the wife's life estate. The daughters then filed an action in the Supreme Court against the wife for breach of fiduciary duty to the daughters, as remainder beneficiaries, in retaining the sale proceeds for herself.

While the Supreme Court case was pending, the wife petitioned the Surrogate's Court of Dutchess County to construe the *in terrorem* clause of the will. The Surrogate's Court ruled that the daughters' commencement of the Supreme Court action interfered with the wife's administration of the estate in violation of the *in terrorem* clause and thus forfeited their legacies under the will. The daughters appealed.

In New York, *in terrorem* clauses are enforceable, but case law provides that such clauses are not favored and must be strictly construed based on the testator's intent. The testator's intent must be determined from reading the will in its entirety and in view of all the facts and circumstances under which the provisions of the will were framed.

The Supreme Court, Appellate Division, held that the beneficiaries did not violate the *in terrorem* clause. The Supreme Court rejected the daughters' argument that the pending Supreme Court action effected a bar to the wife's proceeding in the Surrogate's Court, but found in favor of the daughters on the merits.

The daughters' allegations against the wife in the Supreme Court action did not violate the *in terrorem* clause because the daughters' breach of fiduciary duty allegations did not raise any contest as to the validity of the will, or "otherwise interfere[] with its provisions granting [the wife] discretion to dispose of the estate assets in her capacity as executor." Further, the daughters' allegations that the wife violated the standstill agreement did not implicate any challenge to the will. Accordingly, the Supreme Court reversed the Surrogate's Court and remitted the case to the Surrogate's Court for entry of an amended decree declaring that the daughters' action did not violate the *in terrorem* clause of the will and did not forfeit their legacies under the will.

61. <u>Bazazzadegan v. Vernon</u>, 588 S.W. 3d 796 (Ark. Ct. App. 2019)

Arkansas Court of Appeals holds that an arbitration provision in a trust is mandatory and bound successor co-trustees and beneficiaries of the trust

Dolores Cannon created the Dolores E. Cannon Living Trust on April 4, 2014. After Dolores' death, her daughters, Julia Bazazzadegan and Nancy Vernon, became co-trustees of the trust. Julia and Nancy were also beneficiaries of the trust.

Nancy filed a lawsuit against Julia alleging breach of trust, breach of fiduciary duties as a corporate officer, and misappropriation of funds. In response, Julia moved to compel mediation or arbitration of Nancy's claims.

The trust agreement contained three provisions related to alternative dispute resolution. First, in Section 12.24, the trust agreement empowered the trustee to settle any claims against or in favor of the trust by compromise, adjustment, arbitration or other means.

In Section 11.04 of the trust agreement, Dolores "requested" that any questions or disputes arising during the administration of the trust be resolved by mediation and, if necessary, arbitration.

Finally, in Section 11.14 of the trust agreement, Dolores again "requested" that the trustees settle any matters by mediation or arbitration, unless the trustees agreed otherwise.

The trial court denied Julia's motion to compel mediation and arbitration. Julia appealed.

In construing a trust, the grantor's intent is paramount. The Arkansas Supreme Court has held that the words "I request" represent mandatory direction rather than a permissive or precatory wish.

Furthermore, when a trustee agrees to act as such, the trustee accepts the terms of the trust.

The Arkansas Court of Appeals, Division IV, held that the trust agreement required mediation and arbitration of Nancy's claims. The court found that the word "request" indicated that Dolores intended to require arbitration, rather than merely to give the trustee the choice to arbitrate claims.

The court also held that the arbitration provisions were enforceable against Nancy. Although neither Julia nor Nancy was a party to the trust agreement, each of them had accepted the terms of the trust when she became a trustee. Nancy, as a beneficiary, was also bound by the trust in her individual capacity as a beneficiary, having accepted the benefits of the trust intended for her.

62. <u>Matter of Bruce F. Evertson Dynasty Trust</u>, 446 P.3d 705 (Wyo. 2019)

Wyoming Supreme Court holds that a trustee with the power to distribute income and principal for any purpose had the authority to decant a trust. However, the Supreme Court held that the trial court erred by considering whether a specific decanting proposal was permissible

Bruce Evertson created the Bruce F. Evertson Dynasty Trust, with Evertson Fiduciary Management Corporation as trustee. The beneficiaries of the trust were Bruce's wife, his two children and his children's descendants. Bruce funded the trust with 2,300 acres of ranch and recreational property in Nebraska.

After Bruce's death, the trustee filed a petition for instruction asking the court to confirm it had the power to decant the trust. The trustee also sought approval of its proposed decanting, which involved dividing the trust into two separate trusts, with one trust for Bruce's wife and his daughter and the other trust for Bruce's son, Edward. The trustee claimed that the proposed decanting was in the best interests of the beneficiaries and consistent with Bruce's intent.

Edward objected to the petition and argued, among other things, that the proposed decanting contradicted his father's intentions and constituted a breach of trust. In response, the trustee filed a motion for judgment granting its petition for instructions.

The trial court held that the trustee had the power to decant the trust. Over Edward's objection, the trial court also held that the specific decanting proposal was not a breach of fiduciary duty because the decanting was consistent with Bruce's intent.

Edward appealed.

A judgment on the pleadings is appropriate only if all material facts are admitted in the pleadings and only questions of law remain. If a material fact is in dispute, then judgment on the pleadings is not appropriate.

The Supreme Court of Wyoming affirmed the trial court's ruling that the trustee had the authority to decant the trust. However, the Supreme Court reversed the trial court's finding that the proposed decanting was not a breach of fiduciary duty. The Supreme Court found that Bruce's intent in creating the trust was a material fact for determining whether the decanting constituted a breach of trust, and that the parties disputed what Bruce's intent was. Therefore, the trial court erred by granting a motion on the pleadings except on the limited question of whether the trustee had the power to decant the trust generally.

Decanting is a powerful tool for trustees to modify a trust in light of changes in the law or family circumstances. Although court approval is often not required to exercise the decanting power, a trustee should consider seeking court approval if a beneficiary or another party, such as the IRS or a local tax authority, might contest the decanting.

OTHER ITEMS OF INTEREST

63. United States v. Johnson, ___ F. 3d ____ (10th Cir. 2019)

Four children held responsible for unpaid federal estate taxes on stock received from mother's trust following mother's death

Anna Smith created the Anna Smith Family Trust during life and funded it with shares of stock in State Line Hotel Inc. The trust was governed by Utah law. The hotel was a closely-held corporation and the holder of a Nevada Gaming License. Anna died on September 2, 1991. Upon Anna's death, two of her children, Mary Johnson and James Smith, were named as successor trustees of the trust and as personal representatives of the estate. Her four children were the beneficiaries of the trust.

Consistent with the terms of the trust, the successor trustees filed a federal estate tax return with the Internal Revenue Service. The return calculated the estate's federal estate tax liability at $6,631,448. Of that total, only $4 million was paid to the IRS upon the filing of the return. The successor trustees elected to defer the payment of the balance of the estate tax for five years and then pay the balance in ten equal annual installments under Section 6166 because the hotel stock accounted for more than 35 percent of Anna Smith's adjusted gross estate and was illiquid. The ten annual installment payments would begin on June 2, 1997 and end on June 2, 2006.

Although the assessed estate taxes remained unpaid, the successor trustees distributed the hotel stock from the trust to the four children on December 31, 1992. The distribution was motivated by restrictions under Nevada law on casino ownership by a trust. The trustees also distributed life insurance proceeds. Cognizant of the outstanding federal estate tax liability, the successor trustees and the trust beneficiaries executed a distribution agreement under which the beneficiaries agreed to bear the responsibility for paying additional federal or state estate taxes, interest, or penalties.

The hotel filed for Chapter 11 bankruptcy in January 2002. Beginning with the annual installment due on June 2, 2002, the estate ceased making the installment payments of deferred federal estate tax. The Service declared the installment agreement to be in default as of December 18, 2003. In June 2005, the IRS learned of the existence of the distribution agreement in which the beneficiaries agreed to pay the estate taxes. In 2011, the government filed a complaint against the four children seeking recovery of the $1,569,851 in federal estate tax. The government alleged that all four of decedent's children were liable for the unpaid estate taxes to the extent that they received property included in the gross estate under Section 6324(a)(2). The district court determined that this claim could only be asserted as to life insurance proceeds received by the children as part of the distribution from the estate because the children conceded liability for the on those proceeds.

The government filed an amended complaint in August 2012. In the amended complaint, the government sought to enforce rights as a third party beneficiary of the distribution agreement. The district court ruled in favor of the four children concluding that it was untimely under Utah law and rejecting the government's argument that the timeliness of the claim was governed by federal law. The district court also awarded attorney's fees to the children on the grounds that the government's position on the third party beneficiary claim was not substantially justified.

In the circuit court, the children conceded the government was a third party beneficiary in the distribution agreement but argued the claim was untimely because it was not filed within the six year Utah statute of limitations applicable to contract claims. The circuit court reversed. Instead, the circuit court found that the ten year federal statute of limitations set forth in Section 6502(a) applied based on United States v. Summerlin, 310 U.S. 414 (1940). In that case, the Supreme Court held that "the United States is not bound by state statutes of limitations…in enforcing its rights." The court also ruled with respect to the district court's conclusion the government's claim with respect to insurance proceeds was timely filed. It found that the ten-year federal limitations period was suspended pursuant to Section 6503(d) because the estate made a Section 6166 deferral election. This suspension also applied to transferee liability.

The Tenth Circuit also reversed the district court's award of fees and costs to the children because it ruled in favor of the government on its claim that the four children were liable for the full amount of the unpaid estate taxes since the government was a third party beneficiary to the distribution agreement.

64. **Shaffer v. Commissioner of Revenue _______ Mass. ______ (2020). Petition for writ of certiorari denied by United States Supreme Court (November 9, 2020)**

Massachusetts Supreme Judicial Court addresses impact of federal QTIP election on calculation of Massachusetts estate tax

The issue in Shaffer was whether the intangible assets in a qualified terminable interest property (QTIP) Trust, which was created by predeceasing spouse in New York, were subject to the Massachusetts Estate Tax when the surviving spouse moved to Massachusetts after the death of the first spouse and died while domiciled in Massachusetts. Robert Chuckrow died in July, 1993 while domiciled in New York. His will established a QTIP trust for the benefit of his wife, Adelaide. The trust qualified as a QTIP Trust under both federal and New York law. At the time of Robert's death, the trust assets totaled $844,101.27 and consisted entirely of intangible property. After Robert's death, his estate filed federal and New York estate tax returns. On both returns, the estate reported no tax due, claiming the marital deduction in the full amount of the assets in the trust. Adelaide died domiciled in Massachusetts in 2011. The executors of Adelaide's estate included the value of the QTIP trust assets in computing her federal estate tax, but excluded the QTIP trust assets in computing her Massachusetts estate tax. The Massachusetts Commissioner of Revenue audited the estate's Massachusetts return and assessed an additional Massachusetts estate tax of $1,809,141.88 based on the $13,251,469 date-of-death value of the QTIP assets.

The estate raised two arguments in claiming that the QTIP trust assets were not subject to Massachusetts estate tax. The first argument was that there was only one transfer of QTIP assets, which transfer took place when Robert died in New York, and therefore the Massachusetts assessment of tax violated the due process clause of the Fourteenth Amendment and Article 10 of the Massachusetts Declaration of Rights because there was no transfer of the property in the QTIP trust at Adelaide's death. The second argument was that the QTIP assets were not includable in Adelaide's Massachusetts estate because the definition of "Massachusetts gross estate" in G.L.c.

65C, § 1(f) excludes QTIP property for which only a federal, but not a Massachusetts, QTIP election was made.

The Appellate Tax Board rejected both of the estate's arguments. The Appellate Tax Board first determined that there are two transfers of QTIP assets. The first transfer is from the estate of the first spouse to the surviving spouse when the QTIP election was made for the assets in the trust. The second is from the estate of the surviving spouse to the designated beneficiaries when the surviving spouse dies. The appellate tax board based its decision upon Section 2044(c), which provides, in part, that QTIP property "shall be treated as passing from" the surviving spouse. A passing is the same as a transfer. The second transfer of QTIP assets occurred in Massachusetts and provided the constitutional basis for subjecting the property in the trust to Massachusetts estate tax.

The Appellate Tax Board also rejected the estate's statutory argument. It stated that the section upon which the estate relied, G.L.c. 65C, § 1(f), was inapplicable since it provides that only those QTIP assets for which a Massachusetts deduction is allow in the estate of the first to die spouse are includable in the Massachusetts gross estate of surviving spouse. It concluded that because Robert's estate did not make a Massachusetts QTIP election, there was no Massachusetts QTIP property in Adelaide's estate, and the section did not pertain to the estate's Massachusetts estate tax obligation. Instead, G.L.c 65C, §2A(a) governed and caused the imposition of Massachusetts estate tax on all assets reported in the federal gross estate.

The Massachusetts Supreme Judicial Court first accepted the Appellate Tax Board's conclusion that a transfer occurred upon the death of Adelaide, and therefore the decedent's domicile in Massachusetts provided the constitutional basis for Massachusetts to tax the trust assets. The Court noted that in Fernandez v. Wiener, 326 U.S. 340 (1945), the U. S. Supreme Court stated that an estate tax is not limited to literal transfers at death, but "extends to the creation, exercise, acquisition, or relinquishment of any power or legal privilege which is incident to the ownership of property." It also noted that the federal QTIP rules create fictional transfers in Section 2044(c). Although the surviving spouse receives only a lifetime income interest from the predeceased spouse, the Internal Revenue Code treats property subject to QTIP elections as passing in full from the predeceasing spouse to the surviving spouse. As a result, two transfers of QTIP property occurred for estate tax purposes. Adelaide's domicile in Massachusetts at the time of her death provided a sufficient nexus to impose the Massachusetts estate tax on the transfer of the QTIP assets that was deemed to occur at her death.

In addition, as the Appellate Tax Board held, the statutory definition of the Massachusetts gross estate, which Adelaide's estate tried to use to avoid the imposition of the tax, applied only where the predeceasing spouse made a Massachusetts QTIP election for property that is included in the Massachusetts gross estate of the predeceasing spouse. Robert's estate did not make a Massachusetts QTIP election, nor was there otherwise any Massachusetts QTIP property in the QTIP trust. As a result, under G.L.c 65(c), § 2A, all assets of the estate reported in the federal gross estate would be subject to Massachusetts estate tax.

The estate filed a petition for a writ of certiorari to the U.S. Supreme Court on October 8, 2020 which was denied on November 9, 2020.

Two prior state law cases addressed essentially the same issue. In Comptroller of the Treasury v. Taylor, 189 A.3d 799 (Md. Ct. Spec. App. July 25, 2018), reversed by Maryland Court of Appeals, 21-C-15-055059 (July 29, 2019), the Maryland Court of Appeals addressed the impact of the federal QTIP election on the calculation of the Maryland estate tax at the death of the second spouse. This same issue was addressed in New York in the case of In re Estate of Seiden, NYLJ 10/12/18 p. 23, col. 5 (N.Y. County Surr. Ct.) and by the New York State Legislature in its April 2019 Executive Budget.

The facts in these two cases were simple; however, the consequences could have been complex if the Maryland Court of Appeals (the highest court in Maryland) had not reversed the decision of the Maryland Court of Special Appeals in Taylor in 2019 and if the New York legislature had enacted legislation in 2019 to counter the decision in Seiden. Congress added Section 2056(b)(7) to the Code to permit QTIP trusts to permit the first spouse to die to retain control over the ultimate disposition of the property in a marital trust which would qualify for the estate tax marital deduction Even though the trust for the surviving spouse did not need any of the traditional features that by their terms would include the value of the trust assets in the surviving spouse's gross estate – such as a general power of appointment in the case of Section 2056(b)(5) – that inclusion in the surviving spouse's gross estate was assured by 2044, providing for inclusion whenever a marital deduction was allowed under Section 2056(b)(7) or 2523(f), backstopped by Section 2519 in the case of the surviving spouse's actions during life. This maintained the fundamental character of the marital deduction as a deferral only – the asset escapes tax at the first death but is taxed at the second death.

Since the 2001 Tax Act and the three-year phase-out of the credit for state death taxes between 2002 and 2005, and especially with state legislatures setting their estate tax exemptions lower than the federal basic exclusion amount, some states that still have an estate tax have provided for a state-only QTIP election, available when the estate is under the federal exclusion amount but not under the state exemption, or applicable to the extent the state exemption is less than the federal exclusion amount. But symmetry is lost to the fact that a state is powerless when the surviving spouse moves out of the state. "Worldwide," or nationwide taxation is not allowed for the states, and, under Section 1 of the Fourteenth Amendment to the U.S. Constitution, a citizen of one state loses that citizenship merely by moving to another state.

In Taylor, the predeceased spouse died domiciled in Michigan and created a trust. Both federal and Michigan QTIP elections were made. The surviving spouse moved to Maryland and died domiciled in Maryland.

The Maryland Tax Court held in 2015 that the QTIP property should be taxable as part of the Maryland estate of the surviving spouse. The circuit court then held in 2016 that the federal QTIP election simply enabled the trust assets to be taxable as part of the federal estate. The QTIP election did not convert the trust assets into the personal property of the surviving spouse, which could be subjected to Maryland estate tax.

The Maryland Court of Special Appeals in 2018 affirmed the circuit court and held that Maryland cannot tax the QTIP trust because no Maryland QTIP election had been made. The court cited Code of Maryland-Tax-General § 7-309(b)(6)(i) (emphasis added):

"For purposes of calculating Maryland estate tax, a decedent shall be deemed to have had a qualifying income interest for life under §2044(a) of the Internal Revenue Code with regard to any property for which a marital deduction qualified terminable interest property election was made for the decedent's predeceased spouse *on a timely filed Maryland estate tax return*."

The Maryland Court of Appeals reversed the Maryland Court of Special Appeals in 2019. It held that the state did not seek to tax the property of the first spouse to die or the transfer of the first spouse's property but to tax the deemed transfer of the QTIP property upon the surviving spouse's death as a Maryland resident. The Court of Appeals found § 7-309(b)(6) to be irrelevant since it read that section as only applying to augmenting the Maryland estate with additional property. The QTIP property was included in the surviving spouse's estate under federal law and there was no additional property to augment the Maryland estate. It concluded that the plain language and the legislative history of the pertinent provisions of the Maryland Code revealed that the value of the surviving spouse's estate was the same for federal and Maryland estate tax purposes. Interpreting the statutes otherwise could result in a loophole (as noted in the concurring opinion) where Maryland "would tax only the QTIP trusts that were elected in Maryland estate tax returns, and not QTIP trusts that created in other States, where the beneficiary of the trust resided in Maryland at the time of death."

In Seiden, the predeceased spouse died domiciled in New York in 2010, when there was no federal estate tax. But New York still had its estate tax, and a New York-only QTIP election was made. The surviving spouse did not move out of the state and died domiciled in New York.

The New York court held that New York cannot tax the QTIP trust because New York totally piggybacks on the federal gross estate, and there was no QTIP trust for federal estate tax purposes. Like the Maryland court in Taylor, the New York court relied on the New York statute, New York Tax Law §954(a), which provides that the New York gross estate of a deceased resident "means his or her federal gross estate." Because there was no federal QTIP election, the value of the trust assets was not included in the federal gross estate and hence were not included in the New York gross estate either.

The New York result in Seiden was not limited to surviving spouses of predeceased spouses who died in 2010. For example, if the first spouse died domiciled in New York in 2014 with a gross estate of $10 million, the federal exclusion would have been $5.34 million, and the New York exemption would have been $1 million. A reduce-to-zero marital bequest to a QTIP trust related solely to the federal estate tax would have been $4.66 million, leaving a tentative New York taxable estate of $3.66 million. New York tax could have been avoided with a New York-only QTIP election for a trust funded with $3.66 million. Upon the surviving spouse's death, in 2018 for example (assuming no changes in values), the federal gross estate would include the $4.66 million federal-QTIP trust, but not the $3.66 million New York-only-QTIP trust. A very odd result from the term "New York-only."

The New York State Legislature enacted corrective action to address Seiden in the Executive Budget that Governor Cuomo signed into law on April 12, 2019. The legislation increases the

New York taxable estate of a surviving spouse by the value of the property in the marital trust created at the first spouse's death for which a QTIP election was made for New York estate tax purposes even if a federal QTIP election was not made for the marital trust. This provision is effective for estates of decedents dying on or after April 1, 2019.

65. Changes in State Death Tax Exemptions from 2020 to 2021

Numerous changes occur in state death tax exemptions for 2021 because of legislation or inflation adjustments

As in past years, there have been numerous changes in the exemptions allowed from the separate estate taxes that twelve states and District of Columbia apply in addition to the federal estate tax. An additional five states have separate inheritance taxes. The full state death tax chart which shows the death taxes applicable in the different states is found in the next item.

Legislative Activity. Connecticut and Vermont each saw increases in their state exemptions pursuant to legislation. Connecticut increased its state death tax exemption from $5,100,000 in 2020 to $7,100,000 in 2021 and Vermont increased it exemption from $4,250,000 in 2020 to $5,000,000 in 2021. The District of Columbia reduced its exemption from $5,762,000 in 2020 to $4,000,000 in 2021. The District of Columbia's exemption will be indexed for cost of living beginning in 2022

Indexing Exemptions for Inflation. One development to which estate planning professionals need to pay attention is the increases in the exemptions as a result of inflation adjustments provided in some, but not all, of the states with separate state estate taxes. This has been an area in which there has been increasing complexity. The federal estate death exemption was increased to $10,000,000, adjusted for inflation in 2018 as part of the 2017 Tax Act. The 2021 federal exemption is $11,700,000. No state with a state death tax has yet increased its separate state death tax exemption to match the federal exemption although Connecticut is currently scheduled to increase its exemption to match the federal exemption starting in 2023

Maine, New York, and Rhode Island each adjusted their state death tax exemption for inflation in 2021. In addition, Hawaii, although it appears that its exemption is supposed to be adjusted for inflation, has failed to do so since 2018.

Finally, the State of Washington has not adjusted its exemption for inflation since 2018. In 2018, the Washington State Department of Revenue sent a notice stating that pursuant to Revised Code of Washington § 83.100, the department must adjust the Washington applicable estate tax exclusion map annually using the Seattle-Tacoma-Bremerton Metropolitan Area October Consumer Price Index (Seattle CPI). As of January 1, 2018, the U.S. Bureau of Labor and Statistics no longer calculated Seattle CPI. Instead, the Bureau of Labor and Statistics is calculating CPI for the Seattle-Tacoma-Bellevue core base statistical area. As a result of these changes, the term "Consumer "Price Index" as defined in the statute did not match the current CPI measure calculated by the United States Bureau of Labor Statistics. Consequently, there has been no increase in the exemption in Washington State since 2018.

All of these different changes in recent years mean that only two states have the same exemption from state death tax. These are Massachusetts and Oregon, which each have the lowest state death tax exemption of any of the states, at $1,000,000.

The changes in the exemptions for those states with a state estate tax and the District of Columbia from 2019 to 2020 are summarized in the chart below:

Changes in Exemptions in State Death Taxes – 2020-2021

State	2020 State Death Tax Exemption	2021 State Death Tax Exemption
Connecticut	$5,100,000	$7,100,000
District of Columbia	$5,762,400	$4,000,000
Hawaii	$5,490,000	$5,490,000
Illinois	$4,000,000	$4,000,000
Maine	$5,800,000	$5,900,000
Maryland	$5,000,000	$5,000,000
Massachusetts	$1,000,000	$1,000,000
Minnesota	$3,000,000	$3,000,000
New York	$5,850,000	$5,930,000
Oregon	$1,000,000	$1,000,000

State	2020 State Death Tax Exemption	2021 State Death Tax Exemption
Rhode Island	$1,579,922	$1,595,156
Vermont	$4,250,000	$5,000,000
Washington	$2,193,000	$2,193,000

Planners must be especially careful in planning for clients who reside in a state with a state estate tax or the District of Columbia or who have property located in state with a state estate tax and subject to that state's estate tax. The different exemptions can make this planning quite complicated.

66. **2021 State Death Tax Chart (as of January 1, 2021)**

State Type of Tax	Current Law	2021 State Death Tax Threshold
Alabama None	Tax is tied to federal state death tax credit. AL ST § 40-15-2.	
Alaska None	Tax is tied to federal state death tax credit. AK ST § 43.31.011.	
Arizona None	Tax was tied to federal state death tax credit. AZ ST §§ 42-4051; 42-4001(2), (12). On May 8, 2006, Governor Napolitano signed SB 1170 which permanently repealed Arizona's state estate tax.	
Arkansas None	Tax is tied to federal state death tax credit. AR ST § 26-59-103; 26-59-106; 26-59-109, as amended March, 2003.	

California None	Tax is tied to federal state death tax credit. CA REV & TAX §§ 13302; 13411.	
Colorado None	Tax is tied to federal state death tax credit. CO ST §§ 39-23.5-103; 39-23.5-102.	
Connecticut Separate Estate Tax	On October 31, 2017, the Connecticut Governor signed the 2018-2019 budget which increased the exemption for the Connecticut state estate and gift tax to $2,600,000 in 2018, to $3,600,000 in 2019, and to the federal estate and gift tax exemption in 2020. On May 31, 2018, Connecticut changed its estate tax law to extend the phase-in of the exemption to 2023 to reflect the increase in the federal exemption to $10 million indexed for inflation in the 2017 Tax Act. The exemption will be phased in as follows: 2019: $3.6 million 2020: $5.1 million 2021: $7.1 million 2022: $9.1 million: 2023: federal exemption for deaths on or after January 1, 2023. Beginning in 2019, the cap on the Connecticut state estate and gift tax is reduced from $20 million to $15 million (which represents the tax due on a Connecticut estate of approximately $129 million).	$7,100,000
Delaware None	On July 2, 2017, the Governor signed HB 16 which sunsets the Delaware Estate Tax on December 31, 2017.	

District of Columbia Pick-up Only	No separate QTIP election. DC Bill B22-0685 was introduced in the DC City Council on February 8, 2018. This proposal cut the DC threshold to $5.6 million adjusted for inflation retroactive to January 1, 2018. This change was enacted by the DC City Council on September 5, 2018 as part of the Budget Support Act. In August 2020, the DC City Council enacted the "Estate Tax Adjustment Amendment Act of 2020, which reduces the DC threshold to $4 million in 2021 and which will be adjusted for inflation beginning in 2022.	$4,000,000
Florida None	Tax is tied to federal state death tax credit. FL ST § 198.02; FL CONST. Art. VII, Sec. 5	
Georgia None	Effective July 1, 2014, the Georgia estate tax was repealed. See § 48-12-1.	
Hawaii Modified Pick-up Tax	On May 2, 2012, the Hawaii legislature passed HB 2328 which conforms the Hawaii estate tax exemption to the federal estate tax exemption for decedents dying after January 25, 2012. On June 7, 2018, the governor signed SB 2821, which amended HI ST § 236E-6 to reduce the Hawaiian exemption, effective January 1, 2018, to $5,000,000 indexed for inflation. The Hawaii Department of Taxation released Announcement 2018-13 on September 4, 2018 in which it announced that the exemption will remain at the amount available to decedents dying during 2017.	$5,490,000

	In response to calls from practitioners, the Hawaii Department of Taxation indicated that was not going to adjust the exemption for inflation in 2019. Effective January 1, 2020, Hawaii increased the rate of its state estate tax on estates valued at over $10,000,000 to 20 percent. See Act No. 3 (April 4, 2019).	
Idaho None	Tax is tied to federal state death tax credit. ID ST §§ 14-403; 14-402; 63-3004 (as amended Mar. 2002).	
Illinois Modified Pick-up Only	On January 13, 2011, Governor Quinn signed Public Act 096-1496 which increased Illinois' individual and corporate income tax rates. Included in the Act was the reinstatement of Illinois' estate tax as of January 1, 2011 with a $2 million exemption. Senate Bill 397 passed both the Illinois House and Senate as part of the tax package for Sears and CME on December 13, 2011. It increased the exemption to $3.5 million for 2012 and $4 million for 2013 and beyond. Governor Quinn signed the legislation on December 16, 2011. Illinois permits a separate state QTIP election, effective September 8, 2009. 35 ILCS 405/2(b-1).	$4,000,000
Indiana None	Pick-up tax is tied to federal state death tax credit. IN ST §§ 6-4.1-11-2; 6-4.1-1-4. On May 11, 2013, Governor Pence signed HB 1001 which repealed Indiana's inheritance tax retroactively to January 1, 2013. This replaced Indiana's prior law enacted in 2012 which phased out Indiana's inheritance	.

	tax over nine years beginning in 2013 and ending on December 31, 2021 and increased the inheritance tax exemption amounts retroactive to January 1, 2012	
Iowa Inheritance Tax	Pick-up tax is tied to federal state death tax credit. IA ST § 451.2; 451.13. Effective July 1, 2010, Iowa specifically reenacted its pick-up estate tax for decedents dying after December 31, 2010. Iowa Senate File 2380, reenacting IA ST § 451.2. Iowa has a separate inheritance tax on transfers to others than lineal ascendants and descendants.	
Kansas None	For decedents dying on or after January 1, 2007 and through December 31, 2009, Kansas had enacted a separate stand-alone estate tax. KS ST § 79-15, 203	
Kentucky Inheritance Tax	Pick-up tax is tied to federal state death tax credit. KY ST § 140.130. Kentucky has not decoupled but has a separate inheritance tax and recognizes by administrative pronouncement a separate state QTIP election.	
Louisiana None	Pick-up tax is tied to federal state death tax credit. LA R.S. §§ 47:2431; 47:2432; 47:2434.	
Maine Pick-up Only	For decedents dying after December 31, 2002, pick-up tax was frozen at pre-EGTRRA federal state death tax credit, and imposed on estates exceeding applicable exclusion amount in effect on December 31, 2000 (including scheduled increases under pre-EGTRRA law) (L.D. 1319; March 27, 2003).	$5,900,000

	On June 20, 2011, Maine's governor signed Public Law Chapter 380 into law, which increased the Maine estate tax exemption to $2 million in 2013 and beyond. The rates were also changed, effective January 1, 2013, to 0% for Maine estates up to $2 million, 8% for Maine estates between $2 million and $5 million, 10 % between $ 5 million and $8 million and 12% for the excess over $8 million. On June 30, 2015, the Maine legislature overrode the Governor's veto of LD 1019, the budget bill for fiscal years 2016 and 2017. As part of the law, the Maine Exemption was tagged to the federal exemption for decedents dying on or after January 1, 2016. The tax rates are: 8% on the first $3 million above the Maine Exemption; 10% on the next $3 million above the Maine Exemption; and !2% on all amounts above $6 million above the Maine Exemption. The new legislation did not include portability as part of the Maine Estate Tax. On September 12, 2018, LP1655 became law without the Governor's signature. The new law amends M.R.S. Title 36, Section 4102 and Section 4119 to make the Maine exemption $5,600,000 adjusted for inflation for decedents dying on and after January 1, 2018.	

	For estates of decedents dying after December 31, 2002, Sec. 2058 deduction is ignored in computing Maine tax and a separate state QTIP election is permitted. M.R.S. Title 36, Sec. 4062. Maine also subjects real or tangible property located in Maine that is transferred to a trust, limited liability company or other pass-through entity to tax in a non-resident's estate. M.R.S. Title 36, Sec. 4064.	
Maryland Pick-up Tax Inheritance Tax	On May 15, 2014, Governor O'Malley signed HB 739 which repealed and reenacted MD TAX GENERAL §§ 7-305, 7-309(a), and 7-309(b) to do the following: 1. Increased the threshold for the Maryland estate tax to \$1.5 million in 2015, \$2 million in 2016, \$3 million in 2017, and \$4 million in 2018. For 2019 and beyond, the Maryland threshold will equal the federal applicable exclusion amount. 2. Continued to limit the amount of the federal credit used to calculate the Maryland estate tax to 16% of the amount by which the decedent's taxable estate exceeds the Maryland threshold unless the Section 2011 federal state death tax credit is then in effect. 3. Continued to ignore the federal deduction for state death taxes under Sec. 2058 in computing Maryland estate tax, thus	\$5,000,000

	eliminating a circular computation. 4. Permitted a state QTIP election. On April 5, 2018, HB 0308 became law. The new law provides that for 2019 and thereafter, the Maryland threshold will be capped at the fixed amount of $5 million rather than being equal to the inflation-adjusted federal exemption as provided under prior law. The new law also provides for the portability of the unused predeceased spouse's Maryland exemption amount to the surviving spouse beginning in 2019.	
Massachusetts Pick-up Only	For decedents dying in 2002, pick-up tax is tied to federal state death tax credit. MA ST 65C §§ 2A. For decedents dying on or after January 1, 2003, pick-up tax is frozen at federal state death tax credit in effect on December 31, 2000. MA ST 65C §§ 2A(a), as amended July 2002. Tax imposed on estates exceeding applicable exclusion amount in effect on December 31, 2000 (including scheduled increases under pre-EGTRRA law), even if that amount is below EGTRRA applicable exclusion amount. See, Taxpayer Advisory Bulletin (Dec. 2002), DOR Directive 03-02, Mass. Guide to Estate Taxes (2003) and TIR 02-18 published by Mass. Dept. of Rev. Massachusetts Department of Revenue has issued directive, pursuant to which separate Massachusetts QTIP election	$1,000,000

	can be made when applying state's new estate tax based upon pre-EGTRRA federal state death tax credit.	
Michigan None	Tax is tied to federal state death tax credit. MI ST §§ 205.232; 205.256	
Minnesota Pick-up Only	Tax frozen at federal state death tax credit in effect on December 31, 2000, clarifying statute passed May 2002. Tax imposed on estates exceeding federal applicable exclusion amount in effect on December 31, 2000 (including scheduled increases under pre-EGTRRA law), even if that amount is below EGTRRA applicable exclusion amount. MN ST §§ 291.005; 291.03; instructions for MN Estate Tax Return; MN Revenue Notice 02-16. Separate state QTIP election permitted. On May 30, 2017, the governor signed the budget bill, H.F. No. 1 which increased the Minnesota estate tax exemption for 2017 from $1,800,000 to $2,100,000 retroactively, and increases the exemption to $2,400,000 in 2018, $2,700,000 in 2019, and $3,000,000 for 2020 and thereafter. A provision enacted in 2013 to impose an estate tax on non-residents who own an interest in a pass-through entity which in turn owned real or personal property in Minnesota was amended in 2014 to exclude certain publicly traded entities. It still applies to entities taxed as partnerships or S Corporations that own closely held businesses, farms, and cabins.	$3,000,000

Mississippi None	Tax is tied to federal state death tax credit. MS ST § 27-9-5.	
Missouri None	Tax is tied to federal state death tax credit. MO ST §§ 145.011; 145.091.	
Montana None	Tax is tied to federal state death tax credit. MT ST § 72-16-904; 72-16-905.	
Nebraska County Inheritance Tax	Nebraska through 2006 imposed a pick-up tax at the state level. Counties impose and collect a separate inheritance tax. NEB REV ST § 77-2101.01(1).	
Nevada None	Tax is tied to federal state death tax credit. NV ST Title 32 §§ 375A.025; 375A.100.	
New Hampshire None	Tax is tied to federal state death tax credit. NH ST §§ 87:1; 87:7.	
New Jersey Inheritance Tax	On October 14, Governor Christie signed Assembly Bill A-12 which was the tax bill accompanying Assembly Bill A-10 which revised the funding for the state's Transportation Fund. Under this law, the Pick-Up Tax had a $2 million exemption in 2017 and was eliminated as of January 1, 2018. The new law also eliminated the tax on New Jersey real and tangible property of a non-resident decedent. The repeal of the pick-up tax did not apply to the separate New Jersey inheritance tax.	.

New Mexico None	Tax is tied to federal state death tax credit. NM ST §§ 7-7-2; 7-7-3.	
New York Pick-up Only	The Executive Budget of 2014-2015 which was signed by Governor Cuomo on March 31, 2014 made substantial changes to New York's estate tax. The New York estate tax exemption which was $1,000,000 through March 31, 2014 was increased as follows: April 1, 2014 to March 31, 2015 -- $2,062,500 April 1, 2015 to March 31, 2016 -- $3,125,000 April 1, 2016 to March 31, 2017 -- $4,187,500 April 1, 2017 to December 31, 2018 -- $5,250,000 As of January 1, 2019, the New York estate tax exemption amount will be the same as the federal estate tax applicable exclusion amount **prior** to the 2017 Tax Act which is $5,000,000 adjusted for inflation. The maximum rate of tax will continue to be 16%. Taxable gifts within three years of death between April 1, 2014 and December 31, 2018 will be added back to a decedent's estate for purposes of calculating the New York tax. The New York estate tax is a cliff tax. If the value of the estate is more than	$5,930,000

	105% of the then current exemption, the exemption will not be available. On April 1, 2015, as part of 2015-2016 Executive Budget, New York enacted changes to the New York Estate Tax. New York first clarified that the new rate schedule enacted in 2014 applies to all decedents dying after April 1, 2014. Previously, the rate schedule only applied through March 31, 2015. New York then modified the three year gift add-back provision to make it clear that the gift add-back does not apply to any individuals dying on or after January 1, 2019. Previously, the gift add-back provision did not apply to gifts made on or after January 1, 2019. New York continues not to permit portability for New York estates and no separate state QTIP election is allowed when portability is elected on a federal return.	
North Carolina None	On July 23, 2013, the Governor signed HB 998 which repealed the North Carolina estate tax retroactively to January 1, 2013.	
North Dakota None	Tax is tied to federal state death tax credit. ND ST § 57-37.1-04	
Ohio None	Governor Taft signed the budget bill, 2005 HB 66, repealing the Ohio estate (sponge) tax prospectively and granting credit for it retroactively. This was effective June 30, 2005 and killed the sponge tax. On June 30, 2011, Governor Kasich signed HB 153, the biannual budget bill, which contained a repeal of the	

	Ohio state estate tax effective January 1, 2013.	
Oklahoma None	Tax is tied to federal state death tax credit. OK ST Title 68 § 804 The separate estate tax was phased out as of January 1, 2010.	
Oregon Separate Estate Tax	On June 28, 2011, Oregon's governor signed HB 2541 which replaced Oregon's pick-up tax with a stand-alone estate tax effective January 1, 2012. The new tax has a $1 million threshold with rates increasing from ten percent to sixteen percent between $1 million and $9.5 million. Determination of the estate for Oregon estate tax purposes is based upon the federal taxable estate with adjustments.	$1,000,000
Pennsylvania Inheritance Tax	Tax is tied to the federal state death tax credit to the extent that the available federal state death tax credit exceeds the state inheritance tax. PA ST T. 72 P.S. § 9117 amended December 23, 2003. Pennsylvania had decoupled its pick-up tax in 2002, but has now recoupled retroactively. The recoupling does not affect the Pennsylvania inheritance tax which is independent of the federal state death tax credit. Pennsylvania recognizes a state QTIP election.	
Rhode Island Pick-up Only	Tax frozen at federal state death tax credit in effect on January 1, 2001, with certain adjustments (see below). RI ST § 44-22-1.1.	$1,595,156

	Rhode Island recognized a separate state QTIP election in the State's Tax Division Ruling Request No. 2003-03. Rhode Island's Governor signed into law HB 5983 on June 30, 2009, effective for deaths occurring on or after January 1, 2010, an increase in the amount exempt from Rhode Island estate tax from $675,000, to $850,000, with annual adjustments beginning for deaths occurring on or after January 1, 2011 based on "the percentage of increase in the Consumer Price Index for all Urban Consumers (CPI-U). . . rounded up to the nearest five dollar ($5.00) increment." RI ST § 44-22-1.1. On June 19, 2014, the Rhode Island Governor approved changes to the Rhode Island Estate Tax by increasing the exemption to $1,500,000 indexed for inflation in 2015 and eliminating the cliff tax.	
South Carolina None	Tax is tied to federal state death tax credit. SC ST §§ 12-16-510; 12-16-20 and 12-6-40, amended in 2002.	
South Dakota None	Tax was permanently repealed in 2014 with repeal of all of SDCL § 10-40A, effective July 1, 2014.	
Tennessee None	Pick-up tax is tied to federal state death tax credit. TN ST §§ 67-8-202; 67-8-203. Tennessee had a separate inheritance tax which was phased out as of January 1, 2016.	
Texas None	Tax was permanently repealed effective as of September 15, 2015 when Chapter 211 of the Texas Tax	

	Code was repealed. Prior to September 15, 2015, the tax was tied to the federal state death tax credit.	
Utah None	Tax is tied to federal state death tax credit. UT ST § 59-11-102; 59-11-103.	
Vermont Modified Pick-up	In 2010, Vermont increased the estate tax exemption threshold from $2,000,000 to $2,750,000 for decedents dying on or after January 1, 2011. As of January 1, 2012, the exclusion equaled the federal estate tax applicable exclusion amount, so long as the FET exclusion was not less than $2,000,000 and not more than $3,500,000. VT ST T. 32 § 7442a. On June 18, 2019, Vermont enacted H. 541 which increased the Vermont estate tax exemption to $4,250,000 in 2020 and $5,000,000 in 2021 and thereafter. No separate state QTIP election permitted. Vermont does not permit portability of its estate tax exemption.	$5,000,000
Virginia None	Tax is tied to federal state death tax credit. VA ST §§ 58.1-901; 58.1-902. The Virginia tax was repealed effective July 1, 2007. Previously, the tax was frozen at federal state death tax credit in effect on January 1, 1978. Tax was imposed only on estates exceeding EGTRRA federal applicable exclusion amount. VA ST §§ 58.1-901; 58.1-902.	
Washington Separate Estate Tax	LEGISLATIVE FRAMEWORK. On February 3, 2005, the Washington State Supreme Court unanimously held that	$2,193,000

	Washington's state death tax was unconstitutional. The tax was tied to the current federal state death tax credit, thus reducing the tax for the years 2002 - 2004 and eliminating it for the years 2005 - 2010. Hemphill v. State Department of Revenue 2005 WL 240940 (Wash. 2005). In response to Hemphill, the Washington State Senate on April 19 and the Washington House on April 22, 2005, by narrow majorities, passed a stand-alone state estate tax with rates ranging from 10% to 19%, a $1.5 million exemption in 2005 and $2 million thereafter, and a deduction for farms for which a Sec. 2032A election could have been taken (regardless of whether the election is made). The Governor signed the legislation. WA ST §§ 83.100.040; 83.100.020. Washington voters defeated a referendum to repeal the Washington estate tax in the November 2006 elections. On June 14, 2013, Governor Inslee signed HB 2075 which closed an exemption for marital trusts retroactively immediately prior to when the Department of Revenue was about to start issuing refund checks, created a deduction for up to $2.5 million for certain family owned businesses and indexes the $2 million Washington state death tax threshold for inflation. SEPARATE QTIP ELECTION. Washington permits a separate state QTIP election. WA ST §83.100.047.	

	NO INDEXING FOR INLFATION IN 2019. Washington State was supposed to index the exemption annually for inflation. However, this was not done for 2019. On December 18, 2018, the Department of Revenue sent an email stating that pursuant to Revised Code of Washington (RCW) 83.100, the Department must adjust the Washington applicable estate tax exclusion amount annually using the Seattle-Tacoma-Bremerton metropolitan area October consumer price index (Seattle CPI). As of January 1, 2018, the US Bureau of Labor and Statistics (USBLS) no longer calculates the consumer price index for the Seattle-Tacoma-Bremerton metropolitan area. Instead, the USBLS will calculate the consumer price index for the Seattle-Tacoma-Bellevue Core Based Statistical Area for the Puget Sound region. As a result of these changes, the definition of "consumer price index" in RCW 83.100.020(1)(b) does not match with the current CPI measure calculated by the USBLS. The Department is using the last CPI figure for the Seattle CPI. This resulted in no increase in the applicable exclusion amount for 2019 and 2020.	
West Virginia None	Tax is tied to federal state death tax credit. WV § 11-11-3.	
Wisconsin	Tax is tied to federal state death tax credit. WI ST § 72.01(11m).	

None	For deaths occurring after September 30, 2002, and before January 1, 2008, tax was frozen at federal state death tax credit in effect on December 31, 2000 and was imposed on estates exceeding federal applicable exclusion amount in effect on December 31, 2000 ($675,000), not including scheduled increases under pre-EGTRRA law, even though that amount is below the lowest EGTRRA applicable exclusion amount. Thereafter, tax imposed only on estates exceeding EGTRRA federal applicable exclusion amount. WI ST §§ 72.01; 72.02, amended in 2001; WI Dept. of Revenue website. On April 15, 2004, the Wisconsin governor signed 2003 Wis. Act 258, which provided that Wisconsin will not impose an estate tax with respect to the intangible personal property of a non-resident decedent that has a taxable situs in Wisconsin even if the non-resident's state of domicile does not impose a death tax. Previously, Wisconsin would impose an estate tax with respect to the intangible personal property of a non-resident decedent that had a taxable situs in Wisconsin if the state of domicile of the non-resident had no state death tax.	
Wyoming None	Tax is tied to federal state death tax credit. WY ST §§ 39-19-103; 39-19-104.	