NOTABLE DEVELOPMENTS OF INTEREST TO ESTATE PLANNERS

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NOTABLE DEVELOPMENTS OF INTEREST TO ESTATE PLANNERS

PART 1 – 2017 TAX ACT IS STILL WITH US

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

* 1. **Effective Date and Sunset**

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

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

For estate and gift tax purposes, the 2017 Tax Act increased the basic exclusion amount under section 2010(c)(3) to $10 million as adjusted for inflation with a 2010 base year (the same base year as under prior law). Thus, the basic exclusion amount for 2021 for gift and estate tax purposes, and the generation-skipping transfer (“GST”) exemption amount under section 2631(c), is $11,700,000. Under the current applicable exclusion amount, the number of decedent’s estates subject to federal estate tax may only reach a few thousand, and taxpayers have the ability to make larger gifts during their lives free of gift tax. Just as important, taxpayers with less than the exclusion amount may transfer assets among themselves in order to include assets in the estate of a taxpayer most likely to die soonest. This creates enormous basis planning opportunities.

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

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

(iii) Example 3. Individual B's predeceased spouse, C, died before 2026, at a time when the basic exclusion amount was $11.4 million. C had made no taxable gifts and had no taxable estate. C's executor elected, pursuant to §[20.2010-2](https://www.taxnotes.com/lr/resolve/cyn9), to allow B to take into account C's $11.4 million DSUE amount. B made no taxable gifts and did not remarry. The basic exclusion amount on B's date of death is $6.8 million. Because the total of the amounts allowable as a credit in computing the gift tax payable on B's post-1976 gifts attributable to the basic exclusion amount (zero) is less than the credit based on the basic exclusion amount allowable on B's date of death, this paragraph (c) does not apply. The credit to be applied for purposes of computing B's estate tax is based on B's $18.2 million applicable exclusion amount, consisting of the $6.8 million basic exclusion amount on B's date of death plus the $11.4 million DSUE amount, subject to the limitation of [section 2010(d)](https://www.taxnotes.com/lr/resolve/cpyw#cpyw-0000023).

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

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

6. Anti-abuse Rule

A commenter recommended consideration of an anti-abuse provision to prevent the application of the special rule to transfers made during the increased BEA period that are not true inter vivos transfers, but rather are treated as testamentary transfers for transfer tax purposes. Examples include transfers subject to a retained life estate or other retained powers or interests, and certain transfers within the purview of chapter 14 of subtitle B of the Code. The purpose of the special rule is to ensure that bona fide inter vivos transfers are not subject to inconsistent treatment for estate tax purposes. Arguably, the possibility of inconsistent treatment does not arise with regard to transfers that are treated as part of the gross estate for estate tax purposes, rather than as adjusted taxable gifts. An anti-abuse provision could except from the application of the special rule transfers where value is included in the donor's gross estate at death. Although the Treasury Department and the IRS agree that such a provision is within the scope of the regulatory authority granted in [section 2001(g)(2)](https://www.taxnotes.com/lr/resolve/cp6d#cp6d-0000025), such an anti-abuse provision would benefit from prior notice and comment. Accordingly, this issue will be reserved to allow further consideration of this comment.

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

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

* 1. **Inflation Adjustments**

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

* 1. **Miscellaneous Itemized Deductions**.

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

Because many states base their income tax calculation on federal taxable income, the elimination of many itemized deductions due to Section 67(g) will increase state income taxes for many individuals, trusts and estates as well. Some states have attempted to recast those deductions as charitable contributions. To date, those efforts have failed. In fact, those efforts have done affirmative harm. Previously, the IRS took the position that a state tax credit received for a charitable contribution would not reduce the donor’s income tax deduction. See CCA 201105010. But the IRS has a new position now: a tax credit is a quid pro quo. TD 9864 (June 11, 2019). The Preamble explains:

The new limitation, and the resulting efforts by states and taxpayers to devise alternate means for deducting the disallowed portion of their state and local taxes, has generated increased interest in the question of whether a state or local tax credit should be treated as a return benefit – a quid pro quo – when received in return for making a payment or transfer to an entity described in section 170(c). The Treasury Department and the IRS did not publish formal guidance on this question before the enactment of the limitation under section 164(b)(6). In 2010, however, the IRS Chief Counsel advised that, under certain circumstances, a taxpayer may take a deduction under section 170 for the full amount of a contribution made in exchange for a state tax credit, without subtracting the value of the credit received in return. See CCA 201105010 (Oct. 27, 2010) (“the 2010 CCA”). IRS Chief Counsel has also taken the position in Tax Court litigation that the amount of a state or local tax credit that reduces a tax liability is not an accession to wealth includible in income under section 61 or an amount realized for purposes of section 1001. In these cases, the Tax Court agreed with the Chief Counsel’s position. See, for example, Maines v. Commissioner, 144 T.C. 123, 134 (2015); Tempel v. Commissioner, 136 T.C. 341, 351-54 (2011); aff’d sub nom. Esgar Corp. v. Commissioner, 744 F.3d 648 (10th Cir. 2014).

Upon reviewing the authorities under section 170, the Treasury Department and the IRS questioned the reasoning of the 2010 CCA. On June 11, 2018, the Treasury Department and the IRS issued Notice 2018-54, 2018-24 I.R.B. 750, announcing the intention to propose regulations addressing the federal income tax treatment of contributions pursuant to state and local tax credit programs. On August 27, 2018, the proposed regulations (REG-112176-18) were published in the **Federal Register** (83 FR 43563).

The proposed regulations generally stated that if a taxpayer makes a payment or transfers property to or for the use of an entity listed in section 170(c), and the taxpayer receives or expects to receive a state or local tax credit in return for such payment, the tax credit constitutes a return benefit, or quid pro quo, to the taxpayer and reduces the taxpayer’s charitable contribution deduction. The proposed regulations included a separate rule for state and local tax deductions, providing that they do not constitute a quid pro quo unless they exceed the amount of the donor’s payment or transfer. The proposed regulations also included an exception under which a state or local tax credit is not treated as a quid pro quo if the credit does not exceed 15 percent of the taxpayer’s payment or 15 percent of the fair market value of the property transferred by the taxpayer. Finally, the proposed regulations would amend §1.642(c)-3 to provide similar rules for payments made for a purpose specified in section 170(c) by a trust or decedent’s estate.

The Treasury Department and the IRS received over 7,700 comments responding to the proposed regulations and 25 requests to speak at the public hearing, which was held on November 5, 2018. Copies of written comments received and the list of speakers at the public hearing are available for public inspection at www.regulations.gov or upon request. The comments and revisions are discussed generally in this preamble. After considering the comments received and the concerns expressed at the public hearing, the Treasury Department and the IRS adopt the proposed regulations with certain revisions explained subsequently.

Suppose Congress repeals the SALT cap. Will Treasury reverse its position, again?

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

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

Section 642(h)(2) states that on termination of an estate or trust any deductions (other than the estate or trust exemption and other than the charitable deduction) for the estate or trust in excess of gross income are allowable as deductions to the beneficiaries. This deduction is eliminated due the suspension of miscellaneous itemized deductions for individuals under section 67(g). Beneficiaries may still claim a trust or estate’s net operating losses or capital loss carryovers upon trust or estate termination under section 642(h)(1). The IRS and Treasury have issued generally taxpayer-friendly regulations dealing with section 67(g). T.D. 9918. The summary states:

This document contains final regulations clarifying that the following deductions allowed to an estate or non-grantor trust are not miscellaneous itemized deductions: Costs paid or incurred in connection with the administration of an estate or non-grantor trust that would not have been incurred if the property were not held in the estate or trust, the personal exemption of an estate or non-grantor trust, the distribution deduction for trusts distributing current income, and the distribution deduction for estates and trusts accumulating income. Therefore, these deductions are not affected by the suspension of the deductibility of miscellaneous itemized deductions for taxable years beginning after December 31, 2017, and before January 1, 2026. The final regulations also provide guidance on determining the character, amount, and allocation of deductions in excess of gross income succeeded to by a beneficiary on the termination of an estate or non-grantor trust. The final regulations affect estates, non-grantor trusts (including the S portion of an electing small business trust), and their beneficiaries.

The final regulations amend Treas. Reg. §1.67-4(a), Costs paid or incurred by estates or non-grantor trusts to read as follows:

(a) Deductions — (1) Section 67(e) deductions — (i) In general. An estate or trust (including the S portion of an electing small business trust) not described in [§ 1.67-2T(g)(1)(i)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000547&cite=26CFRS1.67-2T&originatingDoc=I0279E35011D911EB9491EAE54701ADC6&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_34b7000062e27) (a non-grantor trust) must compute its adjusted gross income in the same manner as an individual, except that the following deductions ([section 67(e)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS67&originatingDoc=I0279E35011D911EB9491EAE54701ADC6&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_7fdd00001ca15) deductions) are allowed in arriving at adjusted gross income:

(A) Costs that are paid or incurred in connection with the administration of the estate or trust that would not have been incurred if the property were not held in such estate or trust; and

(B) Deductions allowable under [section 642(b)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS642&originatingDoc=I0279E35011D911EB9491EAE54701ADC6&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_a83b000018c76) (relating to the personal exemption) and [sections 651](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS651&originatingDoc=I0279E35011D911EB9491EAE54701ADC6&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) and [661](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS661&originatingDoc=I0279E35011D911EB9491EAE54701ADC6&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) (relating to distributions).

(ii) Not disallowed under [section 67(g)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS67&originatingDoc=I0279E35011D911EB9491EAE54701ADC6&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_16f4000091d86). [Section 67(e)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS67&originatingDoc=I0279E35011D911EB9491EAE54701ADC6&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_7fdd00001ca15) deductions are not itemized deductions under [section 63(d)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS63&originatingDoc=I0279E35011D911EB9491EAE54701ADC6&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_5ba1000067d06) and are not miscellaneous itemized deductions under [section 67(b)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS67&originatingDoc=I0279E35011D911EB9491EAE54701ADC6&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_a83b000018c76). Therefore, [section 67(e)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS67&originatingDoc=I0279E35011D911EB9491EAE54701ADC6&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_7fdd00001ca15) deductions are not disallowed under [section 67(g)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS67&originatingDoc=I0279E35011D911EB9491EAE54701ADC6&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_16f4000091d86).

(2) Deductions subject to 2-percent floor. A cost is not a [section 67(e)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS67&originatingDoc=I0279E35011D911EB9491EAE54701ADC6&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_7fdd00001ca15) deduction and thus is subject to both the 2-percent floor in [section 67(a)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS67&originatingDoc=I0279E35011D911EB9491EAE54701ADC6&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_8b3b0000958a4) and [section 67(g)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS67&originatingDoc=I0279E35011D911EB9491EAE54701ADC6&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_16f4000091d86) to the extent that it is included in the definition of miscellaneous itemized deductions under [section 67(b)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS67&originatingDoc=I0279E35011D911EB9491EAE54701ADC6&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_a83b000018c76), is incurred by an estate or non-grantor trust (including the S portion of an electing small business trust), and commonly or customarily would be incurred by a hypothetical individual holding the same property.

The most interesting aspect of the final regulations is the ability to pass out unused deductions when an estate or trust terminates. The Summary to the final regulations stated as follows:

1. In General

Section 642(h) provides that if, on the termination of an estate or trust, the estate or trust has: (1) A net operating loss carryover under section 172 or a capital loss carryover under section 1212, or (2) for the last taxable year of the estate or trust, deductions (other than the deductions allowed under section 642(b) (relating to the personal exemption) or section 642(c) (relating to charitable contributions)) in excess of gross income for such year, then such carryover or excess will be allowed as a deduction, in accordance with the regulations prescribed by the Secretary of the Treasury or his delegate (Secretary), to the beneficiaries succeeding to the property of the estate or trust.

Section 1.642(h)-2(a), as articulated in the proposed regulations and these final regulations, provides that if, on termination of an estate or trust, the estate or trust has for its last taxable year deductions (other than the deductions allowed under section 642(b) or section 642(c)) in excess of gross income, the excess deductions are allowed under section 642(h)(2) as items of deduction to the beneficiaries succeeding to the property of the terminated estate or trust.

2. Character and Amount of Excess Deductions

Section 1.642(h)-2(b)(1) of the proposed regulations provides that each deduction comprising the excess deductions under section 642(h)(2) retains, in the hands of the beneficiary, its character (specifically, as allowable in arriving at adjusted gross income, as a non-miscellaneous itemized deduction, or as a miscellaneous itemized deduction) while in the estate or trust. The character of these deductions does not change when succeeded to by a beneficiary on termination of the estate or trust. Furthermore, an item of deduction succeeded to by a beneficiary remains subject to any limitation applicable under the Code in the computation of the beneficiary's tax liability.

The final regulations contain two examples explaining the operation of these rules:

§ 1.642(h)-5 Examples.

Paragraphs (a) and (b) of this section (Examples 1 and 2) illustrate the application of section 642(h).

(a) Example 1: Computations under section 642(h) when an estate has a net operating loss—(1) Facts. On January 31, 2020, A dies leaving a will that provides for the distribution of all of A's estate equally to B and an existing trust for C. The period of administration of the estate terminates on December 31, 2020, at which time all the property of the estate is distributed to B and the trust. For tax purposes, B and the trust report income on a calendar year basis. During the period of administration, the estate has the following items of income and deductions:

|  |  |
| --- | --- |
| **Table 1 to Paragraph (a)(1)** | |
|  |  |
| Income: |  |
| Taxable interest | $2,500 |
| Business income | 3,000 |
| Total income | 5,500 |

|  |  |
| --- | --- |
| **Table 2 to Paragraph (a)(1)** | |
|  |  |
| Deductions: |  |
| Business expenses (including administrative  expense allocable to business income) | 5,000 |
| Administrative expenses not allocable to business income that would not have been incurred if property had not been held in a trust or estate (section 67(e) deductions) | 9,800 |
| Total deductions | 14,800 |

(2) Computation of net operating loss. (i) The amount of the net operating loss carryover is computed as follows:

|  |  |  |
| --- | --- | --- |
| **Table 3 to Paragraph (a)(2)(i)** | | |
|  | |  |
| Gross income | $5,500 |  |
| Total deductions 14,800 | |  |
| Less adjustment under section 172(d)(4)  (allowable non-business expenses ($9,800)  Limited to non-business income ($2,500)) 7,300 | |  |
| Deductions as adjusted | 7,500 |  |
| Net operating loss | | 2,000 |

(ii) Under section 642(h)(1), B and the trust are each allocated $1,000 of the $2,000 unused net operating loss carryover of the terminated estate in 2020, with the allowance of any net operating loss carryover to B and the trust determined under section 172. Neither B nor the trust can carry back any of the net operating loss of A's estate made available to them under section 642(h)(1). See § 1.642(h)-1(b).

(3) Section 642(h)(2) excess deductions. The $7,300 of non-business deductions not taken into account in determining the net operating loss of the estate are excess deductions on termination of the estate under section 642(h)(2). Under § 1.642(h)-2(b)(1), such deductions retain their character as section 67(e) deductions. Under § 1.642(h)-4, B and the trust each are allocated $3,650 of excess deductions based on B's and the trust's respective shares of the burden of each cost.

(4) Consequences for C. The net operating loss carryover and excess deductions are not allowable directly to C, the trust beneficiary. To the extent the distributable net income of the trust is reduced by the net operating loss carryover and excess deductions, however, C may receive an indirect benefit from the carryover and excess deductions.

(b) Example 2: Computations under section 642(h)(2)—(1) Facts. D dies in 2019 leaving an estate of which the residuary legatees are E (75%) and F (25%). The estate's income and deductions in its final year are as follows:

|  |  |
| --- | --- |
| **Table 4 to Paragraph (b)(1)** | |
|  |  |
| Income: |  |
| Dividends | $3,000 |
| Taxable Interest | 500 |
| Rent | 2,000 |
| Capital Gain | 1,000 |
| Total Income | 6,500 |

|  |  |
| --- | --- |
| **Table 5 to Paragraph (b)(1)** | |
|  |  |
| Deductions: |  |
| Section 62(a)(4) deductions: |  |
| Rental real estate expenses | 2,000 |
| Section 67(e) deductions: |  |
| Probate fees 1,500 |  |
| Estate tax preparation fees 8,000 |  |
| Legal fees 2,500 |  |
| Total Section 67(e) deductions | 12,000 |
| Non-miscellaneous itemized deductions: |  |
| Personal property taxes | 3,500 |
| Total deductions | 17,500 |

(2) Determination of character. Pursuant to § 1.642(h)-2(b)(2), the character and amount of the excess deductions is determined by allocating the deductions among the estate's items of income as provided under § 1.652(b)-3. Under § 1.652(b)-3(a), the $2,000 of rental real estate expenses is allocated to the $2,000 of rental income. In the exercise of the executor's discretion pursuant to § 1.652(b)-3(b), D's executor allocates $3,500 of personal property taxes and $1,000 of section 67(e) deductions to the remaining income. As a result, the excess deductions on termination of the estate are $11,000, all consisting of section 67(e) deductions.

(3) Allocations among beneficiaries. Pursuant to § 1.642(h)-4, the excess deductions are allocated in accordance with E's (75 percent) and F's (25 percent) interests in the residuary estate. E's share of the excess deductions is $8,250, all consisting of section 67(e) deductions. F's share of the excess deductions is $2,750, also all consisting of section 67(e) deductions.

(4) Separate statement. If the executor instead allocated $4,500 of section 67(e) deductions to the remaining income of the estate, the excess deductions on termination of the estate would be $11,000, consisting of $7,500 of section 67(e) deductions and $3,500 of personal property taxes. The non-miscellaneous itemized deduction for personal property taxes may be subject to limitation on the returns of both B and C's trust under section 164(b)(6)(B) and would have to be separately stated as provided in § 1.642(h)-2(b)(1).

Example 2 above was criticized as it appeared in the proposed regulations which resulted in the modification:

Section [§ 1.642(h)-5(b)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000547&cite=26CFRS1.642(H)-5&originatingDoc=I0279E35011D911EB9491EAE54701ADC6&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)), Example 2, of the proposed regulations (Example 2) demonstrates computations under [section 642(h)(2)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS642&originatingDoc=I0279E35011D911EB9491EAE54701ADC6&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_1d410000745d2). The expenses in Example 2 include rental real estate taxes in an attempt to illustrate a deduction subject to limitation under [section 164(b)(6)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS164&originatingDoc=I0279E35011D911EB9491EAE54701ADC6&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_61d20000b6d76) to the beneficiary that must be separately stated as provided in [§ 1.642(h)-2(b)(1)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000547&cite=26CFRS1.642(H)-2&originatingDoc=I0279E35011D911EB9491EAE54701ADC6&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_a83b000018c76).

Multiple commenters noted that Example 2 raises several issues that could be potentially relevant to that example, such as whether the decedent was in a trade or business and the application of [section 469](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS469&originatingDoc=I0279E35011D911EB9491EAE54701ADC6&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) to estates and trusts. To avoid these issues, which are extraneous to the point being illustrated, one commenter suggested that the example be revised so that the entire amount of real estate expenses on rental property equals the amount of rental income. The Treasury Department and the IRS did not intend to raise such issues in the example and consider both issues to be outside the scope of these regulations. Accordingly, the Treasury Department and the IRS adopt the suggestion by the commenter and modify Example 2 to avoid these issues by having rental real estate expenses entirely offset rental income with no unused deduction.

Commenters also noted that Example 2 does not properly allocate rental real estate expenses because the example characterizes the rental real estate taxes as itemized deductions. These commenters asserted that real estate taxes on property held for the production of rental income are not itemized deductions but instead are allowed in computing gross income and cited to [section 62(a)(4)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS62&originatingDoc=I0279E35011D911EB9491EAE54701ADC6&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_d40e000072291) as providing that ordinary and necessary expenses paid or incurred during the taxable year for the management, conservation, or maintenance of property held for the production of income under [section 212(2)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS212&originatingDoc=I0279E35011D911EB9491EAE54701ADC6&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_58730000872b1) that are attributable to property held for the production of rents are deductible as above-the-line deductions in arriving at adjusted gross income. One commenter suggested that, if the goal of Example 2 is to illustrate state and local taxes passing through to the beneficiary, then the example should include state income taxes rather than real estate taxes on rental real estate. The Treasury Department and the IRS have revised this example in the final regulations to include personal property tax paid by the trust rather than taxes attributable to rental real estate.

Lastly, commenters noted that Example 2 does not demonstrate the broad range of trustee discretion in [§ 1.652(b)-3(b)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000547&cite=26CFRS1.652(B)-3&originatingDoc=I0279E35011D911EB9491EAE54701ADC6&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_a83b000018c76) and [(d)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000547&cite=26CFRS1.652(B)-3&originatingDoc=I0279E35011D911EB9491EAE54701ADC6&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_5ba1000067d06) for deductions that are not directly attributable to a class of income, or deductions that are, but which exceed such class of income, respectively. In response to these comments, the Treasury Department and the IRS have modified Example 2 to illustrate the application of trustee discretion as found in [§ 1.652(b)-3(b)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000547&cite=26CFRS1.652(B)-3&originatingDoc=I0279E35011D911EB9491EAE54701ADC6&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_a83b000018c76) and [(d)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000547&cite=26CFRS1.652(B)-3&originatingDoc=I0279E35011D911EB9491EAE54701ADC6&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_5ba1000067d06).

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

* 1. **Divorce – Income Tax**.

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

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

* 1. **Basis of Life Insurance Policies.**

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

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

PART 2 – IS MORE TAX REFORM ON THE WAY?

As of August 30, 2021, the Senate has a Democrat majority derived from the Vice-President’s power to break tie votes. The existing filibuster rules remain because a majority of current senators dread minority status more than they enjoy majority status; that is, by nature they prefer to block what they perceive as awful more than they hope to enact what they think is likely to improve things a little. For purposes of “hammering the rich” this suggests no retroactivity and small rather than grand steps, on wealth transfer taxes. Might the applicable exclusion be reduced sooner than January 1, 2026? Sure, although that would be a largely cosmetic step; the increase is already in budget projections so the additional revenue would be that from 2022-2025, a mere four years. Might it be reduced below the “sunset” level? Perhaps – it was $3.5 million not very long ago (2009). The Tax Policy Center ([www.taxpolicycenter.org](http://www.taxpolicycenter.org)) projects that a restoration of the 2009 estate tax ($3.5 million, no indexing, 45% rate) would subject 0.65% of estates taxable by 2030 and raise $67.2 billion, versus making the current rules permanent which would tax 0.10% of estates and raise $22.3 billion. One could imagine a principle that we would not have a generally applicable tax unless it applied to at least 1% of taxpayers. Congress is not in the principles business but such in this instance would lead to an interesting discussion: apply the estate tax more broadly or repeal it?

What of other suggestions. Wealth taxes are the current rage – a rare instance of US political figures who generally admire European leadership not liking what they have done, which is reject wealth taxes – because it would generate “instant” revenue. Some supporters of such taxes are in the Biden administration. Over the long expanse of history wealth taxes generally are imposed when a country stares in the face of war. Accordingly other approaches may be more likely. Some are within the existing system: eliminating valuation discounts as “allowed” after Rev. Rul. 93-12 and/or changing the effect of Rev. Rul. 85-13 to eliminate or limit the benefits of sales to grantor trusts or the effectiveness of GRATs. Others are new or novel.

Ending the step-up in basis seems like an obvious move if it contains provisions to “protect” those who do not pay estate tax now. A benefit of reducing the applicable exclusion is that it would reduce the number of taxpayers who feel entitled to both no estate tax and a step-up, so that the step-up could then be eliminated with less cost. At least theoretically. Other proposals such as imposing the estate tax on assets held in grantor trusts (a Sanders proposal) seem like long-shots. What about having capital gains realized at death? That perhaps is not quite as long a long-shot but at this point the proposals are hardly thought through enough to consider in any detail. For instance, farms and businesses might be protected but what is a business? Suppose I practice law but own a rental house? Is that a business? Suppose I own 25?

If capital gains rates increase, there may be a rationale to end the step-up because otherwise “everyone” will just hold assets until death. Once you start down that path, you may want to eliminate other planning, such as using grantor trusts.

Lawyers in high-cost areas like New York and Washington have long proclaimed that at low enough tax rates taxpayers will pay taxes rather than tax lawyers. In most of the country the cost of tax planning is so inexpensive that rates are irrelevant to the planning decision. A rate of 40% or 45% is not foreordained for the estate tax; within the last generation the marginal rate was as high as 60%. A return to graduated rates, perhaps steeply, could be perceived as striking a blow against “the rich.” Similarly, on the income tax side steeply graduated rates could yield interesting results – both budget and sociological – if Congress were willing. Suppose there were no step-up in basis but there were a lower capital gains rate if assets were sold within two years of a decedent’s death. Such innovation would require creativity and where creativity might come from is unclear.

An increase in the capital gains rate seems likely. Accordingly, selling before the increase is desirable if a sale is to occur anyway. For assets in trust there is an easy solution. Suppose the assets are in trust 1. Trust 2 is created, that is not a grantor trust with respect to trust 1 but that has similar beneficiaries, albeit not identical terms with trust 1.. A distribution is made from trust 1 to trust 2 “on behalf of” the beneficiaries. This may require an amendment of trust 1. Under section 643(e) an election may be made AFTER the end of 2021 (when we know whether the capital gains rates went up in 2021 or not). Section 643(e) provides:

(e) Treatment of property distributed in kind

(1) Basis of beneficiary. The basis of any property received by a [beneficiary](https://www.law.cornell.edu/definitions/uscode.php?width=840&height=800&iframe=true&def_id=26-USC-565102875-1195617238&term_occur=999&term_src=title:26:subtitle:A:chapter:1:subchapter:J:part:I:subpart:A:section:643) in a distribution from an estate or trust shall be—

(A) the adjusted basis of such property in the hands of the estate or trust immediately before the distribution, adjusted for

(B) any gain or loss recognized to the estate or trust on the distribution.

(2) Amount of distribution. In the case of any distribution of property (other than [cash](https://www.law.cornell.edu/definitions/uscode.php?width=840&height=800&iframe=true&def_id=26-USC-3046195-2063077224&term_occur=999&term_src=title:26:subtitle:A:chapter:1:subchapter:J:part:I:subpart:A:section:643)), the amount taken into account under sections [661(a)(2)](https://www.law.cornell.edu/uscode/text/26/661#a_2) and [662(a)(2)](https://www.law.cornell.edu/uscode/text/26/662#a_2) shall be the lesser of—

(A) the basis of such property in the hands of the [beneficiary](https://www.law.cornell.edu/definitions/uscode.php?width=840&height=800&iframe=true&def_id=26-USC-565102875-1195617238&term_occur=999&term_src=title:26:subtitle:A:chapter:1:subchapter:J:part:I:subpart:A:section:643) (as determined under paragraph (1)), or

(B) the fair market value of such prop­erty.

(3) Election to recognize gain

(A) In general. In the case of any distribution of property (other than [cash](https://www.law.cornell.edu/definitions/uscode.php?width=840&height=800&iframe=true&def_id=26-USC-3046195-2063077224&term_occur=999&term_src=title:26:subtitle:A:chapter:1:subchapter:J:part:I:subpart:A:section:643)) to which an election under this paragraph applies—

(i) paragraph (2) shall not apply,

(ii) gain or loss shall be recognized by the estate or trust in the same manner as if such property had been sold to the distributee at its fair market value, and

(iii) the amount taken into account under sections [661(a)(2)](https://www.law.cornell.edu/uscode/text/26/661#a_2) and [662(a)(2)](https://www.law.cornell.edu/uscode/text/26/662#a_2) shall be the fair market value of such property.

(B) Election. Any election under this paragraph shall apply to all distributions made by the estate or trust during a [taxable](https://www.law.cornell.edu/definitions/uscode.php?width=840&height=800&iframe=true&def_id=26-USC-1532917883-1195617239&term_occur=999&term_src=) year and shall be made on the return of such estate or trust for such [taxable](https://www.law.cornell.edu/definitions/uscode.php?width=840&height=800&iframe=true&def_id=26-USC-1532917883-1195617239&term_occur=999&term_src=) year.

Any such election, once made, may be revoked only with the consent of the Secretary.

(4) Exception for distributions described in section 663(a). This subsection shall not apply to any distribution described in section 663(a).

The following chart describes the major features of the proposals thus far (as of August 30, 2021).

**Possible 2021 Federal Tax Legislation of Interest to Estate Planners**

|  | **STEP Act[[1]](#footnote-2)**  **S. \_\_\_**  **(Discussion Draft)[[2]](#footnote-3)**  **Sen. Van Hollen, et al.[[3]](#footnote-4)**  **March 29, 2021** | **For the 99.5% Act**  **S. 994**  **Sen. Sanders, et al.[[4]](#footnote-5)**  **March 25, 2021** | **H.R. 2286**  **Rep. Pascrell**  **March 29, 2021** | **American Families Plan**  **(Fact Sheet)**  **President Biden**  **April 28, 2021** | **“Greenbook”[[5]](#footnote-6)**  **Treasury Department**  **May 28, 2021** |
| --- | --- | --- | --- | --- | --- |
| **Transfer Tax**  **Rates** |  | 45% up to $10 million  50% up to $50 million  55% up to $1 billion  65% at and over $1 billion |  | 45% (informally floated during campaign and **NOT** part of American Families Plan) |  |
| **Transfer Tax Exemptions** |  | $3.5 million for estate tax and GST tax  $1 million for gift tax |  | $3.5 million for estate tax (informally floated during campaign and **NOT** part of American Families Plan) |  |
| **Income Tax Rates** |  |  |  | 39.6% ordinary income top rate;  39.6% LTCG rate if household income $1 million or more | 39.6% ordinary income top rate;  39.6% LTCG and qualified dividends rate if household income $1 million or more |
| **Valuation** |  | No discounts for non-business assets inside entity; no entity-level discounts if transferor, transferee and family have control or majority ownership unless entity equity is actively traded |  |  |  |
| **Basis Adjustment**  **At Death** |  | Not for assets held in decedent’s grantor trust  that’s not included in decedent’s gross estate |  | Not for gains of over $1 million (single) or $2.5  million (spouses); exemptions for family-owned businesses and farms if family continues to operate |  |
| **Deemed Sale Rules** | Gifted assets deemed sold for FMV; assets held at death deemed sold for FMV (LTCG tax deductible for estate tax purposes); above rules don’t apply to “ordinary” TPP or to assets passing to spouse, QTIP trust, charity, trust for charity or grantor trust includable in gross estate; all assets held in trust (other than in an excepted trust) deemed sold for FMV every 21 years (or on 12/31/26 if trust created before 2006); assets in grantor trust deemed sold for FMV – **if**:   * Assets are distributed; * Grantor trust status ceases; or * Includability in gross estate ceases   Appraisal costs income tax deductible; no underpayment of estimated tax penalties for tax arising from deemed sales at death; 6166-type deferral possible for up to 15 years; $100,000 indexed) lifetime exclusion of gain; $1 million (indexed) exclusion of gain at death (reduced by amount of lifetime exclusion used) |  | Gifted assets deemed sold for FMV; assets held at death deemed sold for FMV; above rules don’t apply to “ordinary” TPP or to assets passing to spouse, QDOT trust the entirety of which spouse can appoint, charity or grantor trust includable in gross estate; certain trust modifications and decantings would be deemed sales for FMV; assets held 30 years in trust (other than in an excepted trust) deemed sold for FMV every 30 years (or on 01/01/22 if then already held 30 years); assets in grantor trust deemed sold for FMV – **if**:   * Assets are distributed; * Grantor trust status ceases; or * Includability in gross estate ceases   6166-type deferral possible for up to 7 years; $1 million (indexed after 2022) exclusion of net capital gain; annual exclusion gifts also excluded |  | Gifted assets deemed sold for FMV; assets held at death deemed sold for FMV (capital gains tax deductible for estate tax purposes); above rules don’t apply to “ordinary” TPP or to assets passing to surviving “U.S.” spouse or to charity (special rule for transfers to split-interest trusts); assets held in trust, partnership or non-corporate entity deemed sold for FMV every 90 years (or on 01/01/30 if then already held 90 years); appraisal costs income tax deductible; no underpayment of estimated tax penalties for tax arising from deemed sales at death; capital gains tax would not be due on family-owned and operated businesses; 6166-type deferral possible for up to 15 years (except for publicly traded securities, etc.); $1 million (indexed after 2022) aggregate exclusion of gain (portable to spouse) for transfers during life and at death; current basis rules would apply to those transfers; value of “partial interests” determined without discounts; transfers into or out of trusts (unless deemed wholly-owned and revocable by “donor”), partnerships or other non-corporate entities deemed sold for FMV |
| **GRATs** |  | Minimum term 10 years; maximum term 10 years plus life expectancy; $500,000 or 25% minimum remainder interest at outset; no decrease in annuity payment amount during term |  |  |  |
| **Treatment of Grantor**  **Trusts** |  | Included in gross estate; distributions are gifts; cessation of grantor trust status is gift – **if**:   * Grantor is deemed owner; or * Non-grantor is deemed owner and engages in sale or exchange with trust |  |  |  |
| **GST Exemption** |  | Allocation to trust lasts for 50 years from date of trust creation or date of statute’s enactment |  |  |  |
| **Annual Exclusion**  **Gifts** |  | **Per donor** limit of double annual exclusion amount – **if**:   * Gift in trust; * Gift of pass-through entity interest; or * Gifted asset can’t be sold or liquidated immediately |  |  |  |
| **Reporting to IRS** | Annual full accounting; names, addresses and EINs of grantor, Trustee and all beneficiaries – **if** trust:   * Is over $1 million; **or** * Has over $20,000 in gross income |  | Name and EIN of transferee of asset(s) along with asset description(s), basis and FMV; basis and FMV also to be reported to recipient |  |  |
| **Effective Date(s)** | Deaths and transfers after 12/31/**20** | Various | Deaths and transfers after 12/31/21 |  | Deaths and transfers after 12/31/21[[6]](#footnote-7) |

PART 3 – ESTATE PLANNING PRACTICE IN 2018 AND BEYOND

1. WHERE WE ARE TODAY
   1. **New Planning Approaches**
      1. Given the large Applicable Exclusion Amount, it becomes clear that for many even traditional clients the estate tax has disappeared as an issue. This could change depending on political developments and is to change anyway on January 1, 2026; many clients are under $24 million but above $12 million.
      2. As 2026 approaches, absent change, we will be faced with enormous pressure to enable clients to make gifts to use the soon to exercise basis exemption amount. Laying the groundwork today for such a possibility seems wise.
      3. Estate planners will focus more of the tax planning for clients on the income tax, rather than the transfer taxes. In particular, it is likely estate planning will focus on tax basis planning and maximizing the “step-up” in basis at death.
      4. Because the “step-up” in basis may come at little or no transfer tax cost, estate planners will seek to force estate tax inclusion in the future.
      5. The state of residence of the client and his or her beneficiaries will greatly affect the estate plan. In other words, if a client is domiciled in California, and his or her beneficiaries living in California, then dying with the assets may be the extent of the tax planning. On the other hand, if the beneficiaries live in a state like Texas that has no state income tax, then transferring the assets out of the estate during the lifetime of the client may be warranted. As a result, estate planners will need to ask clients two questions that, in the past, did not significantly matter: (a) Where are you likely to be domiciled at your death? and (b) Naturally, at your death, your children, grandchildren, and other beneficiaries will be lovingly at your bedside, but where are they likely to be domiciled then?

Another example of the importance of domicile can be seen in Shaffer v. Commissioner of Revenue, 148 N.E.3d 1197 (Ma. 2020), in which the first spouse to die did so domiciled in New York leaving a QTIP trust for the survivor who later died domiciled in Massachusetts in 2011. Massachusetts had an estate tax based on the size of the federal estate, which included the QTIP assets. The estate argued no Massachusetts QTIP election had been made but the court determined that was not relevant here. The estate also argued that the estate tax was unconstitutional when applied in this manner. The court concluded that the state could tax transfers of property rights and that the decedent’s right in the QTIP transferred to the remainder beneficiaries at her death. The US Supreme Court declined to hear the case.

* 1. **Portability Planning**
     1. Portability, at least in theory, can provide additional capacity for the surviving spouse’s estate to benefit from a “step-up” in basis with little or no transfer tax costs. The extent to which portability is being used is uncertain. The 2017 IRS statistical data showed only 681 nontaxable portability returns filed.
     2. In traditional by-pass trust planning, upon the death an individual who has a surviving spouse, assets of the estate equal in value to the decedent’s unused Applicable Exclusion Amount fund a trust (typically for the benefit of the surviving spouse and, perhaps, descendants). The trust is structured to avoid estate tax inclusion at the surviving spouse’s estate. The marital deduction portion is funded with any assets in excess of the unused Applicable Exclusion Amount. The by-pass trust avoids estate tax inclusion at the surviving spouse’s estate. From an income tax standpoint, however, the assets in the by-pass trust do not receive a “step-up” in basis upon the death of the surviving spouse. Furthermore, while the assets remain in the by-pass trust, any undistributed taxable income above minimal amounts will be subject to the highest income tax rates at the trust level.
     3. In portability planning, the decedent’s estate would typically pass to the surviving spouse under the marital deduction, and the DSUE Amount would be added to the surviving spouse’s Applicable Exclusion Amount. Because all of the assets passing from the decedent to the surviving spouse in addition to the spouse’s own asset will be subject to estate taxes at his or her death, the assets will receive a “step-up” in basis. Additional income tax benefits might be achieved if the assets that would otherwise have funded the by-pass trust are taxed to the surviving spouse, possibly benefiting from being taxed a lower marginal income tax bracket. In addition, if the by-pass trust would have been subject to a high state income tax burden, having the assets taxed to a surviving spouse who moves to a low or no income tax state would provide additional income tax savings over traditional by-pass trust planning.
     4. Of course, there are other considerations, including creditor protection, “next spouse” issues and potential “Medicaid” planning, which would favor by-pass trust planning. From a tax standpoint, the trade-off is the potential estate tax savings of traditional by-pass trust planning against the potential income tax savings of portability planning. Because the DSUE Amount does not grow with the cost-of-living index, very large estates will benefit more with traditional by-pass trust planning because all of the assets, including any appreciation after the decedent’s death, will pass free of transfer taxes. On the other hand, smaller but still significant estates should consider portability as an option because the combined exclusions -- the DSUE Amount frozen but the surviving spouse’s Applicable Exclusion Amount growing with the cost-of-living index -- is likely to allow the assets to pass at the surviving spouse’s death with a full step-up in basis with little or no transfer tax costs (unless the assets are subject to significant state death taxes at that time).

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

* + 1. In evaluating the income tax savings of portability planning, planners will want to consider that even for very large estates, the surviving spouse has the option of using the DSUE Amount by making a taxable gift to a grantor trust. The DSUE Amount is applied against a surviving spouse’s taxable gift first before reducing the surviving spouse’s Applicable Exclusion Amount (referred to as the basic exclusion amount). The grantor trust would provide the same estate tax benefits as the by-pass trust, but the assets would be taxed to the surviving spouse as a grantor trust thus allowing the trust assets to appreciate out of the surviving spouse’s estate without being burdened by income taxes. If the assets appreciate, then this essentially solves the problem of the DSUE Amount being frozen in value. Moreover, the grantor trust likely provides for a power to exchange assets of equivalent value with the surviving spouse who can exchange high basis assets for low basis assets of the grantor trust prior to death and essentially effectuate a “step-up” in basis for the assets in the grantor trust.
    2. Although a “step-up” in basis is great in theory, no tax will be saved if there is a loss at the time of death resulting in a “step-down” in basis or the asset is income in respect of a decedent (IRD). Furthermore, even if the assets receive a “step-up” in basis, will anyone benefit? Many assets, like family-owned businesses, may never be sold or may be sold so far in the future that the benefit of a step-up is attenuated. On the other hand, if the asset that receives a “step-up” in basis is either depreciable or depletable under the Code, the deductions that arise do result in tax benefits to the owners of that asset. Similarly, an increase in the tax basis of an interest in a partnership or in S corporation shares may not provide immediate tax benefits, but they do allow additional capacity of the partner or shareholder to receive tax free distributions from the entity. These concepts and how certain assets benefit or don’t benefit from the basis adjustment at death are discussed in more detail below.
    3. Portability planning is slightly less appealing to couples in community property states because, as discussed below, all community property gets a “step-up” in basis on the first spouse’s death. Thus, the need for additional transfer tax exclusion in order to benefit from a subsequent “step-up” in basis is less crucial. This is not true, however, for assets that are depreciable (commercial real property) or depletable (mineral interests). As discussed below, these types of assets will receive a “step-up” in basis but over time, the basis of the asset will be reduced by the ongoing depreciation deductions. As such, even in community property states, if there are significant depreciable or depletable assets, portability should be considered.

1. OBTAINING AND RETAINING BASIS
   1. **Generally**
      1. As discussed above, estate planning will increasingly focus on the income tax savings resulting from the “step-up” in basis. Estate planners will seek to maximizing the “step-up” up in basis by ensuring that the assets that are includible in the estate of a decedent are the type of assets that will:
         1. Benefit from a “step-up” (avoiding the inclusion cash or property that has a basis greater than fair market value)
         2. Benefit the most from the “step-up” (for example, very low basis assets, collectibles, and “negative basis” assets); and
         3. Provide significant income tax benefits to the beneficiaries (assets are likely to be sold in a taxable transaction after “step-up” or depreciable/depletable assets giving rise to ongoing income tax deductions).
      2. In addition to the foregoing, estate planners will increasingly seek to:
         1. Maximize the value of certain assets because the step-up” in basis is based on fair market value (rather than trying to reduce the value for transfer tax purposes); and
         2. Intentionally create estate tax inclusion, especially if the decedent lives in a state with no state death tax and if the decedent has significant unused Available Exclusion Amount above his or her assets.
   2. **Swapping Assets with Existing Grantor Trusts**
      1. Many individuals have made significant taxable gifts, using all or a significant portion of their Available Exclusion Amounts. Many of those gifts were made to grantor trusts.
      2. A common power used to achieve grantor trust status for the grantor trust is one described under section 675(4)(C), namely giving the grantor, the power, in a non-fiduciary capacity, to reacquire the trust corpus by substituting other property of an equivalent value. For income tax purposes, transactions between the grantor and the grantor trust will be disregarded, at least as of now. As such, grantors may exercise the power to swap high basis assets for low basis assets without jeopardizing the estate tax includibility of the assets and without having a taxable transaction for income tax purposes.
      3. To maximize the benefits of the swap power, it must be exercised as assets appreciate or are sold over time. When exercised properly, this can ensure that only those assets that benefit the most from the step-up will be subject to estate inclusion.
         1. If grantor does not have sufficient other assets, repurchase will be difficult - although the donor could borrow cash from a third party. What are the results if cash is borrowed by the grantor, the grantor buys assets from the trust, the trust loans the cash back to the grantor, the grantor pays back the third party lender and, at death, the grantor’s estate satisfies the note to the trust with assets having fair market value basis?
         2. The income tax consequences if a note is used to repurchase property are uncertain because the trust’s basis in note may equal grantor’s original carryover basis in the asset given to the trust and now reacquired so paying off the note may generate gain). In other words, if grantor trust status terminates because the grantor dies, and the trust owns a note from the grantor – now the grantor’s estate – the note likely does not receive a step-up in basis so when the estate pays it off the trust will have gain.
         3. Because the sudden or unexpected death of the grantor may make a repurchase difficult or impossible, estate planners may want to consider drafting “standby” purchase instruments to facilitate fast implementation of repurchase.
   3. **Should Valuation Discounts Be Undone?**
      1. Where assets have been divided among generations to create discounts, consideration should be given to undoing those arrangements if the effect is to depress the value of an estate below the amount of Available Exemption Amount in order to increase the income tax basis of the assets.
      2. Discount entities could be dissolved or restated to allow the parties to the entity to withdraw.
         1. An option could be given to a parent allowing the sale of the parent’s interest to a child or children for undiscounted fair market value at death. Giving such an option to a parent would be a gift unless accompanied by adequate and full consideration.
         2. If undivided interests in property are owned, agreements could be entered into that require all generations to consent to the sale of the property as one tract if any one owner wanted to sell. Quite obviously such agreements may be contrary to other estate planning or ownership goals of the family.
         3. The ability of the IRS to ignore provisions of an agreement that increase the value of assets in the hands of a parent, but not in the hands of a child, is uncertain. By its literal terms, section 2703 of the Code applies only to provisions that reduce value and to restrictions on the right to sell or use property. To illustrate, in Estate of James A. Elkins, Jr., et al. v. Commissioner, 140 T.C. No. 5 (2013), the Tax Court applied section 2703 to ignore a family co-tenancy agreement requiring all owners of fractional interests in art to agree before the art could be sold. The purpose of that agreement was to limit the marketability of a fractional interest.

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

* 1. **Powers of Appointment For Basis Purposes**
     1. Generally
        1. Consideration should be given to using a “circumscribed general power” that has the following characteristics: (1) a testamentary power, (2) in favor of the creditor of the powerholder’s estate, (3) with the consent of a non-adverse party, (4) only over assets with a fair market value in excess of basis, and (5) capped such that the amount subject to the power when added to the other assets of the powerholder produces a total that is $1,000 less than the powerholder’s Basic Exclusion Amount.
        2. The rights of creditors to property over which a powerholder has a testamentary general power is worth considering. The majority view at common law is that the powerholder of a power, conferred on the powerholder by another, is treated as the beneficial owner of the appointive property for purposes of creditors’ rights only if (1) the power is general *and* (2) the powerholder exercises the power. No distinction is made between a testamentary and a presently exercisable power. Creditors of a powerholder of a *non*general power, on the other hand, cannot reach the appointive assets even if the power was effectively exercised. The theory is that the donor who creates a nongeneral power did not intend to benefit the powerholder.

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

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

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

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

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

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

* + 1. Power of Appointment Not Subject to Fiduciary Standard. In In re Estate of Zucker, 2015 WL 5254061 (Pa. Superior Ct. 2015), decedent’s wife, Syma, exercised a power of appointment in favor of two of three children. The third, Wendy, objected claiming:

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

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

We have reviewed the language contained in Decedent's will and in the codicil to Syma's will in which she directed that the principal contained in the marital trust be divided into two trusts for the benefit of Scott and Karyn and their issue. We have also reviewed the case law provided by the parties and the orphans' court. We conclude that none of the cases, in which challenges to the exercise of the power of appointment were raised, direct that the appointments must be made in good faith. Rather, we state again that a donee's duty is to the donor and the donee must exercise that power within the donor's established conditions. Moreover, the donee has the right to select some of the potential appointees to the exclusion of others. See Estate of Kohler, 344 A.2d at 472. No duty of good faith has been established. Therefore, we conclude that the orphans' court's grant of Scott and Karyn's motion for judgment on the pleadings was proper. The orphans' court did not commit an error of law.

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

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

A trustee “has a duty to administer the trust according to the trust instrument ....” (§ 16000.) A trustee also only has the powers conferred by the trust instrument and the powers conferred by statute, unless limited by the trust instrument. (§ 16200.) Here, the very language of the Marital Trust allowed Berkowitz to act in his capacity as the surviving spouse (not the trustee) and designate himself as the recipient of the Trust assets. The Marital Trust then required the trustee to distribute the assets to any person designated by the surviving spouse, including the surviving spouse himself. Thus, under the plain terms of the Marital Trust, Berkowitz (acting as the trustee) was required to transfer the assets once he exercised the power of appointment in his favor. He could not possibly have breached any fiduciary duties by doing something that was expressly authorized and required under the terms of the Marital Trust. (Hearst v. Ganzi (2006) 145 Cal.App.4th 1195, 1207-1208, 52 Cal.Rptr.3d 473 [trustees did not breach their fiduciary duties where their actions were explicitly authorized by the trust].)

Finally, we note that Berkowitz's exercise of his power of appointment would have been unobjectionable if he had resigned as trustee before exercising the power. In that scenario, the successor trustee (Tubbs) would have been required to transfer the assets to Berkowitz once he exercised the power of appointment in his favor. Tubbs claims “those are not the facts before this Court,” but we see no reason why the result should be different where Berkowitz was both the donee and the trustee who had no discretion but to follow the terms of the power of appointment.

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

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

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

Trustees shall hold and manage the property in this trust and ... may encroach on such part of the principal thereof as the Trustees may deem necessary to provide for the support in reasonable comfort of my wife and to provide for the proper support and education of my descendants[.] To the extent practicable, however, I request the Trustees in making encroachment for the benefit of my wife to encroach first on any trust created for my wife ... before encroaching on this trust for my wife[.]

My primary desire is that my wife be supported in reasonable comfort during her lifetime and that my children be supported in reasonable comfort during their lives; my secondary desire is that the principal of this trust be preserved as well as possible consonant with the consummation of my primary objective[.]

[My wife] shall have no power to appoint [trust] property to herself, to her estate, to her creditors, or to the creditors of her estate.

\* \* \*

Sometime after the will was probated, a dispute arose between the co-executors and co-trustees over the administration of the estate and the by-pass trust, pitting Mary and Calhoun against Alex and David. Alex and David filed petitions for accounting and damages for breach of duties as executors and trustees against Mary and Calhoun, and sought the removal of Mary and Calhoun as executors and trustees in probate court. Mary and Calhoun each moved for summary judgment on all claims, and the superior court granted their motions. Alex and David appealed those rulings.

In the first appearance of this case before this Court, we reversed the trial court’s grant of summary judgment to Calhoun in an unpublished opinion. See *Peterson I*. One month later, the Supreme Court of Georgia in *Peterson II* reversed the trial court’s grant of summary judgment to Mary for similar reasons. Both cases held that material issues of fact remained with respect to Appellees’ failure to fully fund the trusts at issue in the case and whether Appellees wasted assets. See *Peterson I*, slip op. at pp. 7-8, 10; *Peterson II*, 303 Ga. at 215-217 (3), 811 S.E.2d 309.

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

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

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

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

Under the terms of the deeds creating these trusts, the trustees were granted broad discretionary powers with respect to both the distribution of income to the beneficiaries and the investment and management of the corpus of the trusts. Notwithstanding the designation of Richards and Russell as trustees, it further appears that at all times from the establishment of the trusts until his last illness, the decedent exercised complete control with respect to the purchase and sale of trust assets, investment of any proceeds, and the determination of the amounts, if any, to be distributed to the respective beneficiaries.

The assets of the various trusts, together with other trusts, as well as property owned by the decedent, were accounted for by a single set of records maintained in the offices of the decedent. Except for the Federal income tax returns prepared and filed by the decedent on behalf of the various trusts, no separate records were maintained showing the assets and income of any of these trusts.

The respondent argues that the decedent should be treated as trustee, in fact, possessing such rights and powers as to cause the inclusion of the assets thereof in his gross estate, relying on sections 2033, 2036 (a)(2), and 2038. Section 2033 requires a finding that the decedent had an interest in the assets of the trusts at the time of his death. There is no basis for such a finding. Section 2038(a)(1) relates to "a power" exercisable by the decedent "to alter, amend, revoke, or terminate," the trusts. No such power was reserved by the decedent. Accordingly, in the final analysis the respondent's position is predicated on the determination that by reason of the de facto control exercised by the decedent the trusts are includable in his estate pursuant to section 2036(a)(2).[5](http://www.leagle.com/decision/197377232extcm740_1619#fid5) It is clear that the powers granted to the trustees would, if reserved by the decedent, be such as to require the inclusion of the assets of the trusts in the estate of the decedent. *United States v. O'Malley* [66-1 USTC ¶ 12,388], [383 U.S. 627](http://www.leagle.com/cite/383%20U.S.%20627) (1966). Does the fact that the decedent was able to exercise such powers through the cooperation of unrelated trustees require a different result? The question thus presented for decision is whether the value of such trusts is includable in the estate of the decedent by reason of the de facto control over the trusts exercised by the decedent, notwithstanding that no power to exercise such control was reserved to or by the decedent once he resigned his duties as trustee of certain of these trusts.

[footnotes omitted]

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

PART 4 – FEDERAL RULINGS, CASES AND OTHER DEVELOPMENTS

# INCOME TAX MATTERS

## **Consistent Basis Reporting**

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

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

A. [Section 1014(f)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS1014&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)#co_pp_ae0d0000c5150)

[Section 1014(f)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS1014&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)#co_pp_ae0d0000c5150) imposes an obligation of consistency between the basis of certain inherited property and the value of that property for Federal estate tax purposes.

[Section 1014(f)(1)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS1014&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)#co_pp_9daf00009de57) provides that the basis of property acquired from a decedent cannot exceed that property's final value for purposes of the Federal estate tax imposed on the estate of the decedent, or, if the final value has not been determined, the value reported on a statement required by section 6035(a).

[Section 1014(f)(2)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS1014&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)#co_pp_ac4e0000281c0) provides that [section 1014(f)(1)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS1014&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)#co_pp_9daf00009de57) only applies to property the inclusion of which in the decedent's gross estate increased the estate's liability for the Federal estate tax (reduced by credits allowable against the tax).

[Section 1014(f)(3)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS1014&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)#co_pp_f8fc0000f70d0) provides that, for purposes of [section 1014(f)(1)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS1014&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)#co_pp_9daf00009de57), the basis of property has been determined for Federal estate tax purposes if (A) the value of the property is shown on a return under section 6018 and that value is not contested by the Secretary before the expiration of the time for assessing the estate tax; (B) in a case not described in (A), the value is specified by the Secretary and that value is not timely contested by the executor of the estate; or (C) the value is determined by a court or pursuant to a settlement agreement with the Secretary.

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

(b) Property subject to consistency requirement—(1) In general. Property subject to the consistency requirement in paragraph (a)(1) of this section is any property that is includable in the decedent's gross estate under section 2031, any property subject to tax under section 2106, and any other property the basis of which is determined in whole or in part by reference to the basis of such property (for example as the result of a like-kind exchange or involuntary conversion) that generates a tax liability under chapter 11 of subtitle B of the Code (chapter 11) on the decedent's estate in excess of allowable credits, except the credit for prepayment of tax under chapter 11.

(2) Exclusions. For purposes of paragraph (b)(1) of this section, property that qualifies for an estate tax charitable or marital deduction under section 2055, 2056, or 2056A, respectively, does not generate a tax liability under chapter 11 and therefore is excluded from the property subject to the consistency requirement in paragraph (a)(1) of this section. For purposes of paragraph (b)(1) of this section, tangible personal property for which an appraisal is not required under § 20.2031-6(b) is deemed not to generate a tax liability under chapter 11 and therefore also is excluded from the property subject to the consistency requirement in paragraph (a)(1) of this section.

(3) Application. For purposes of paragraph (b)(1) of this section, if a liability under chapter 11 is payable after the application of all available credits (other than a credit for a prepayment of estate tax), the consistency requirement in paragraph (a)(1) of this section applies to the entire gross estate (other than property excluded under paragraph (b)(2) of this section) because all such property contributes to the liability under chapter 11 and therefore is treated as generating a tax liability under chapter 11. If, however, after the application of all such available credits, no tax under chapter 11 is payable, the entire gross estate is excluded from the application of the consistency requirement.

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

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

Proposed § 1.1014-10(a)(1) provides that a taxpayer's initial basis in certain property acquired from a decedent may not exceed the final value of the property as that term is defined in § 1.1014-10(c). This limitation applies to the property whenever the taxpayer reports to the IRS a taxable event with respect to the property (for example, depreciation or amortization) and continues to apply until the property is sold, exchanged, or otherwise disposed of in one or more transactions that result in the recognition of gain or loss for Federal income tax purposes. The property for this purpose includes any other property the basis of which is determined in whole or in part by reference to the basis of the property acquired from the estate or as a result of the death of the decedent (for example as the result of a like-kind exchange or involuntary conversion).

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[Section 1014(f)(3)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS1014&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)#co_pp_f8fc0000f70d0) provides that, for purposes of [section 1014(f)(1)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS1014&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)#co_pp_9daf00009de57), the final value of property has been determined for Federal estate tax purposes if: (A) The value is reported on a Federal estate tax return filed with the IRS and is not contested by the IRS before the period of limitation on assessment expires; (B) the value is specified by the IRS and is not timely contested by the executor of the estate; or (C) the value is determined by a court or pursuant to a settlement agreement with the IRS.

Proposed § 1.1014-10(c)(1) defines the final value of property that is reported on a Federal estate tax return filed with the IRS. That value is the value reported on the Federal estate tax return once the period of limitations on assessment for adjusting or contesting that value has expired. The IRS may specify a value for the property by determining a value in the course of carrying out its responsibilities under section 7803(a)(2). If the IRS determines a value different from the value reported, the final value is the value determined by the IRS once that value can no longer be contested by the estate. If the value determined or specified by the IRS is timely contested by the estate, the final value is the value determined in an agreement that is binding on all parties, or the value determined by a court once the court's determination is final.

Proposed § 1.1014-10(c)(2) provides that the recipient of property to which the consistency requirement applies may not claim a basis in excess of the value reported on the statement required to be furnished under [section 6035(a)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS6035&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)#co_pp_8b3b0000958a4) (the value shown on the Federal estate tax return) if the taxpayer's basis in the property is relevant for any purpose under the Internal Revenue Code before the final value of that property has been determined under proposed § 1.1014-10(c)(1). However, under [section 1014(f)(1)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS1014&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)#co_pp_9daf00009de57), basis cannot exceed the property's final value. Therefore, proposed § 1.1014-10(c)(2) provides that, if the final value is determined before the period of limitation on assessment expires for any Federal income tax return of the recipient on which the taxpayer's basis is relevant and the final value differs from the initial basis claimed with respect to that return, a deficiency and an underpayment may result.

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

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

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

(3) After-discovered or omitted property—(i) Return under section 6018 filed. In the event property described in paragraph (b)(1) of this section is discovered after the estate tax return under section 6018 has been filed or otherwise is omitted from that return (after-discovered or omitted property), the final value of that property is determined under section (c)(3)(i)(A) or (B) of this section.

(A) Reporting prior to expiration of period of limitation on assessment. The final value of the after-discovered or omitted property is determined in accordance with paragraph (c)(1) or (2) of this section if the executor, prior to the expiration of the period of limitation on assessment of the tax imposed on the estate by chapter 11, files with the IRS an initial or supplemental estate tax return under section 6018 reporting the property.

(B) No reporting prior to expiration of period of limitation on assessment. If the executor does not report the after-discovered or omitted property on an initial or supplemental Federal estate tax return filed prior to the expiration of the period of limitation on assessment of the tax imposed on the estate by chapter 11, the final value of that unreported property is zero. See Example 3 of paragraph (e) of this section.

(ii) No return under section 6018 filed. If no return described in section 6018 has been filed, and if the inclusion in the decedent's gross estate of the after-discovered or omitted property would have generated or increased the estate's tax liability under chapter 11, the final value, for purposes of [section 1014(f)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS1014&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)#co_pp_ae0d0000c5150), of all property described in paragraph (b) of this section is zero until the final value is determined under paragraph (c)(1) or (2) of this section. Specifically, if the executor files a return pursuant to section 6018(a) or (b) that includes this property or the IRS determines a value for the property, the final value of all property described in paragraph (b) of this section includible in the gross estate then is determined under paragraph (c)(1) or (2) of this section.

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

7. Requirement To Provide Information Return and Statement(s) Under [Section 6035](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS6035&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search))

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

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

8. Circumstances Under Which No Information Return or Statement(s) Is Required Under [Section 6035](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS6035&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search))

Commenters expressed concern that the [section 6035](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS6035&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)) filing requirements might extend to a return filed by an estate solely to make the portability election under section 2010(c)(5), or a generation-skipping transfer tax election or exemption allocation. The proposed regulations provide that the filing requirements of [section 6035](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS6035&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)) do not apply to such returns because these returns are not required by section 6018.

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

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

10. Beneficiaries

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

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Proposed § 1.6035-1(c)(4) provides that, if the executor is unable to locate a beneficiary by the due date of the Information Return, the executor is required to report that on that Information Return and explain the efforts taken to locate the beneficiary. If the executor subsequently locates the beneficiary, the executor is required to furnish the beneficiary with a Statement and file a supplemental Information Return with the IRS within 30 days of locating the beneficiary. If the executor is unable to locate a beneficiary and distributes the property to a different beneficiary who was not identified in the Information Return as the recipient of that property, the executor is required to file a supplemental Information Return with the IRS and furnish the successor beneficiary with a Statement within 30 days after distributing the property.

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

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

As discussed earlier in this preamble, [section 6035(a)(2)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS6035&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)#co_pp_d86d0000be040) imposes a reporting requirement on the executor of the decedent's estate and on any other person required to file a return under section 6018. The purpose of this reporting is to enable the IRS to monitor whether the basis claimed by an owner of the property is properly based on the final value of that property for estate tax purposes. The Treasury Department and the IRS are concerned, however, that opportunities may exist in some circumstances for the recipient of such reporting to circumvent the purpose of the statute (for example, by making a gift of the property to a complex trust for the benefit of the transferor's family).

Accordingly, pursuant to the regulatory authority granted in [section 6035(b)(2)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS6035&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)#co_pp_c0ae00006c482), the proposed regulations require additional information reporting by certain subsequent transferors in limited circumstances. Specifically, proposed § 1.6035-1(f) provides that, with regard to property that previously was reported or is required to be reported on a Statement furnished to a recipient, when the recipient distributes or transfers (by gift or otherwise) all or any portion of that property to a related transferee, whether directly or indirectly, in a transaction in which the transferee's basis for Federal income tax purposes is determined in whole or in part with reference to the transferor's basis, the transferor is required to file and furnish with the IRS and the transferee, respectively, a supplemental Statement documenting the new ownership of this property. This proposed reporting requirement is imposed on each such recipient of the property. For purposes of this provision, a related transferee means any member of the transferor's family as defined in section 2704(c)(2), any controlled entity (a corporation or any other entity in which the transferor and members of the transferor's family, whether directly or indirectly, have control within the meaning of section 2701(b)(2)(A) or (B)), and any trust of which the transferor is a deemed owner for income tax purposes.

In the event such transfer occurs before a final value is determined within the meaning of proposed § 1.1014-10(c), the transferor must provide the executor with a copy of the supplemental Statement filed with the IRS and furnished to the transferee reporting the new ownership of the property. When a final value is determined, the executor will then provide a supplemental Statement to the new transferee instead of to the transferor. The supplemental Statements are due no later than 30 days after the transferor distributes or transfers all or a portion of the property to the transferee.

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

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

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

(e) Duty to supplement.—(1) In general. In the event of any adjustment to the information required to be reported on the Information Return or any Statement as described in paragraph (e)(2) of this section, the executor must file a supplemental Information Return with the IRS including all supplemental Statements and furnish a corresponding supplemental Statement to each affected beneficiary by the due date described in paragraph (e)(4) of this section.

(2) Adjustments requiring supplement. Except as provided in paragraph (e)(3) of this section, an adjustment to which the duty to supplement applies is any change to the information required to be reported on the Information Return or Statement that causes the information as reported to be incorrect or incomplete. Such changes include, for example, the discovery of property that should have been (but was not) reported on an estate tax return described in section 6018, a change in the value of property pursuant to an examination or litigation, or a change in the identity of the beneficiary to whom the property is to be distributed (pursuant to a death, disclaimer, bankruptcy, or otherwise). Such changes also include the executor's disposition of property acquired from the decedent or as a result of the death of the decedent in a transaction in which the basis of new property received by the estate is determined in whole or in part by reference to the property acquired from the decedent or as a result of the death of the decedent (for example as the result of a like-kind exchange or involuntary conversion). Changes requiring supplement pursuant to this paragraph (e)(2) are not inconsequential errors or omissions within the meaning of § 301.6722-1(b) of this chapter.

(3) Adjustments not requiring supplement—(i) In general. A supplemental Information Return and Statement may but they are not required to be filed or furnished

(A) To correct an inconsequential error or omission within the meaning of § 301.6722-1(b) of this chapter, or

(B) To specify the actual distribution of property previously reported as being available to satisfy the interests of multiple beneficiaries in the situation described in paragraph (c)(3) of this section.

The timing requirements of supplemental reporting is strict:

Due date of supplemental reporting—(i) In general. Except as provided in paragraph (e)(4)(ii) of this section, the supplemental Information Return must be filed and each supplemental Statement must be furnished on or before 30 days after—

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

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

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

(ii) Probate property or property from decedent's revocable trust. With respect to property in the probate estate or held by a revocable trust at the decedent's death, if an event described in paragraph (e)(4)(i)(A), (B), or (C) of this section occurs after the decedent's date of death but before or on the date the property is distributed to the beneficiary, the due date for the supplemental Information Return and corresponding supplemental Statement is the date that is 30 days after the date the property is distributed to the beneficiary. If the executor chooses to furnish to the beneficiary on the Statement information regarding any changes to the basis of the reported property as described in § 1.1014-10(a)(2) that occurred after the date of death but before or on the date of distribution, that basis adjustment information (which is not part of the requirement under [section 6035](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS6035&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search))) must be shown separately from the final value required to be reported on that Statement.

(f) Subsequent transfers. If all or any portion of property that previously was reported or is required to be reported on an Information Return (and thus on the recipient's Statement or supplemental Statement) is distributed or transferred (by gift or otherwise) by the recipient in a transaction in which a related transferee determines its basis, in whole or in part, by reference to the recipient/transferor's basis, the recipient/transferor must, no later than 30 days after the date of the distribution or other transfer, file with the IRS a supplemental Statement and furnish a copy of the same supplemental Statement to the transferee. The requirement to file a supplemental Statement and furnish a copy to the transferee similarly applies to the distribution or transfer of any other property the basis of which is determined in whole or in part by reference to that property (for example as the result of a like-kind exchange or involuntary conversion). In the case of a supplemental Statement filed by the recipient/transferor before the recipient/transferor's receipt of the Statement described in paragraph (a) of this section, the supplemental Statement will report the change in the ownership of the property and need not provide the value information that would otherwise be required on the supplemental Statement. In the event the transfer occurs before the final value is determined within the meaning of proposed § 1.1014-10(c), the transferor must provide the executor with a copy of the supplemental Statement filed with the IRS and furnished to the transferee in order to notify the executor of the change in ownership of the property. When the executor subsequently files any Return and issues any Statement required by paragraphs (a) or (e) of this section, the executor must provide the Statement (or supplemental Statement) to the new transferee instead of to the transferor. For purposes of this provision, a related transferee means any member of the transferor's family as defined in section 2704(c)(2), any controlled entity (a corporation or any other entity in which the transferor and members of the transferor's family (as defined in section 2704(c)(2)), whether directly or indirectly, have control within the meaning of section 2701(b)(2)(A) or (B)), and any trust of which the transferor is a deemed owner for income tax purposes. If the transferor chooses to include on the supplemental Statement provided to the transferee information regarding any changes to the basis of the reported property as described in § 1.1014-10(a)(2) that occurred during the transferor's ownership of the property, that basis adjustment information (which is not part of the requirement under [section 6035](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS6035&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search))) must be shown separately from the final value required to be reported on that Statement.

There are penalty provisions as well described by the summary:

Section 2004(c) of the Act added a new accuracy-related penalty for underpayments attributable to an inconsistent estate basis. See [section 6662(b)(8)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS6662&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)#co_pp_200d000029713).

[Section 6662(k)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS6662&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)#co_pp_340a00009b6f3) provides that there is an inconsistent estate basis if the basis of property claimed on a return exceeds the basis as determined under [section 1014(f)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS1014&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)#co_pp_ae0d0000c5150).

Section 2004(c) of the Act adds statements under [section 6035](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS6035&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)) to the list of information returns and payee statements subject to the penalties under [section 6721](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS6721&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)) and [section 6722](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS6722&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)), respectively. Specifically, the Act adds new paragraph (D) to [section 6724(d)(1)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS6724&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)#co_pp_e07e0000a9f57) to provide that the term information return means any statement required to be filed with the Secretary under [section 6035](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS6035&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)). The Act also adds new paragraph (II) to [section 6724(d)(2)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS6724&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)#co_pp_4be3000003be5) to provide that the term payee statement means any statement required to be furnished under [section 6035](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS6035&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)) (other than a statement described in [section 6724(d)(1)(D)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS6724&originatingDoc=I86BA96C0E1DF11E5BAAD9792D8D66846&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)#co_pp_dff00000c8783)).

## **Termination of Trust Results In Capital Gains**

. In PLR 201932001 the IRS considered the termination of a trust along actuarial lines. The facts presented were:

On Date 1, a date prior to September 25, 1985, Settlor created an irrevocable trust, Trust, for the benefit of Son. The material purpose of Trust was to ensure that Son receive an income stream for his support. Under the terms of the Trust agreement, the trustees are required to distribute all of the net income of Trust to Son, and, upon his death, distribute the remainder to his issue, per stirpes. The Trust agreement does not authorize any distributions of principal during Son's life. Son has four living adult children (Current Remaindermen) and eight living grandchildren, four of whom are adults (Successor Remaindermen). None of Son's descendants has a predeceased child with living issue. Son and Bank are currently serving as co-trustees of Trust.

State Statute provides, in relevant part, that matters that may be resolved by a nonjudicial settlement include termination of the trust, provided that court approval of such termination is obtained in accordance with this section, and the court must conclude that continuance of the trust is not necessary to achieve any material purpose of the trust. State Statute further provides that upon such termination, the court may order the trust property distributed as agreed by the parties to the agreement or otherwise as the court determines is equitably consistent with the purposes of the trust.

On Date 2, Son, the Current Remaindermen and the Successor Remaindermen entered into Agreement. Agreement states that the continuance of Trust “is no longer necessary to achieve any clear material purpose of such trust because [[Son]'s net worth has grown significantly, such that he does not need income from [Trust] for his support.” Agreement further provides for the termination of Trust and the distribution of Trust's assets among Son, the Current Remaindermen and the Successor Remaindermen in accordance with the actuarial value of each beneficiary's share (Proposed Distribution).,

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

[Rev. Rul. 72-243, 1972-1 C.B. 233](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1972019755&pubNum=0001048&originatingDoc=I8c98882fbac911e9a76eb9e71287f4ea&refType=CA&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)), provides that the proceeds received by the life tenant of a trust, in consideration for the transfer of the life tenant's entire interest in the trust to the holder of the remainder interest, are treated as an amount realized from the sale or exchange of a capital asset under [§ 1222](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS1222&originatingDoc=I8c98882fbac911e9a76eb9e71287f4ea&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)). The right to income for life from a trust estate is a right in the estate itself. See [McAllister v. Commissioner, 157 F.2d 235 (2d Cir. 1946)](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1946114272&pubNum=0000350&originatingDoc=I8c98882fbac911e9a76eb9e71287f4ea&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)), cert. denied, [330 U.S. 826 (1947)](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1946201698&pubNum=0000780&originatingDoc=I8c98882fbac911e9a76eb9e71287f4ea&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)).

In [Rev. Rul. 69-486, 1969-2 C.B. 159](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1969013744&pubNum=0001048&originatingDoc=I8c98882fbac911e9a76eb9e71287f4ea&refType=CA&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)), a non-pro rata distribution of trust property was made in kind by the trustee, although the trust instrument and local law did not convey authority to the trustee to a make a non-pro rata distribution of property in kind. The distribution was effected as a result of a mutual agreement between the trustee and the beneficiaries. Because neither the trust instrument nor local law conveyed authority to the trustee to make a non-pro rata distribution, [Rev. Rul. 69-486](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1969013744&pubNum=0001048&originatingDoc=I8c98882fbac911e9a76eb9e71287f4ea&refType=CA&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) held that the transaction was equivalent to a pro rata distribution followed by an exchange between the beneficiaries, an exchange that required recognition of gain under [§ 1001](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS1001&originatingDoc=I8c98882fbac911e9a76eb9e71287f4ea&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)).

Although the proposed transaction takes the form of a distribution of the present values of the respective interests of Son, the Current Remaindermen, and the Successor Remaindermen, in substance it is a sale of Son's and the Successor Remaindermen's interests to the Current Remaindermen. [Rev. Rul. 69-486](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1969013744&pubNum=0001048&originatingDoc=I8c98882fbac911e9a76eb9e71287f4ea&refType=CA&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)).

The amounts received by Son as a result of the termination of Trust are amounts received from the sale or exchange of a capital asset to the Current Remaindermen. [Rev. Rul. 72-243](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1972019755&pubNum=0001048&originatingDoc=I8c98882fbac911e9a76eb9e71287f4ea&refType=CA&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)). Because Son's basis in the income interest of Trust is a portion of the entire basis of the property under [§ 1015(b)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS1015&originatingDoc=I8c98882fbac911e9a76eb9e71287f4ea&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_a83b000018c76), and because the disposition of Son's term interests is not part of a transaction in which the entire interest in Trust is transferred to a third party, Son's adjusted basis in Son's interest in Trust is disregarded under [§ 1001(e)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS1001&originatingDoc=I8c98882fbac911e9a76eb9e71287f4ea&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_7fdd00001ca15). Son's holding period in the life interests in Trust exceeds one year. Accordingly, based on the facts submitted and representations made, the entire amount realized by Son as a result of the early termination of Trust will be long-term capital gain under [§ 1222(3)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS1222&originatingDoc=I8c98882fbac911e9a76eb9e71287f4ea&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_d08f0000f5f67).

Similarly, the amounts received by the Successor Remaindermen as a result of the termination of Trust are amounts received from the sale or exchange of a capital asset to the Current Remaindermen. Cf. [Helvering v. Gambrill, 313 U.S. 11, 15 (1941), 1941-1 C.B. 364](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1941120893&pubNum=0000780&originatingDoc=I8c98882fbac911e9a76eb9e71287f4ea&refType=RP&fi=co_pp_sp_780_15&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_780_15) (The phrase “property held by the taxpayer” under a prior law holding period rule relating to capital gains and losses includes not only full ownership, but also any interest owned whether vested, contingent, or conditional). The Successor Remaindermen's holding period in their interests in Trust also exceeds one year. Accordingly, under [§ 1222(3)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS1222&originatingDoc=I8c98882fbac911e9a76eb9e71287f4ea&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_d08f0000f5f67), the gain determined under [§ 1001(a)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS1001&originatingDoc=I8c98882fbac911e9a76eb9e71287f4ea&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_8b3b0000958a4) by the Successor Remaindermen as a result of the early termination of Trust will be long-term capital gain.

In addition, to the extent that a Current Remainderman exchanges property, including property deemed received from Trust, for the interests of Son and the Successor Remaindermen, the Current Remainderman will recognize gain or loss on the property exchanged. Accordingly, based on the facts submitted and representations made, for purposes of determining gain or loss, the amount realized by each Current Remainderman on the exchange of property for Trust interests held by Son and the Successor Remaindermen will be equal to amount of cash and fair market value of the trust interests received in exchange for the transferred assets. [Section 1.1001-1(a)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000547&cite=26CFRS1.1001-1&originatingDoc=I8c98882fbac911e9a76eb9e71287f4ea&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_8b3b0000958a4) and [Rev. Rul. 69-486](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1969013744&pubNum=0001048&originatingDoc=I8c98882fbac911e9a76eb9e71287f4ea&refType=CA&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)).

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

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

## **Trust As Agent In Purchase Of Annuity**

. In PLR 202118002, a non-grantor trust bought an annuity on the life of the sole beneficiary, A. Additional facts stated in the ruling are:

A, B, and C serve as co-trustees for the Trust. Under the terms of the Trust, A may not alienate or otherwise transfer A's interest in the Trust during A's lifetime.

The co-trustees of the Trust intend to purchase a single premium deferred annuity contract for the Trust. The Trust is to be the owner and beneficiary of the annuity contract during the life of A. A is to be the measuring life for the annuity contract.

If A dies, the annuity contract's proceeds (if any) will be paid to the Trust. The Trust will then pay the proceeds to A's designated heir and terminate.

**REPRESENTATIONS**

The following additional representations were made in connection with this ruling request:

1. No co-trustee of the Trust may withdraw property from the Trust without the consent of at least one other co-trustee.

2. The Trust is a taxable trust under [section 641](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS641&originatingDoc=I21357934b1c811ebb647818ecdfac784&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)) and is not a grantor trust under [section 671](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS671&originatingDoc=I21357934b1c811ebb647818ecdfac784&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)).

The annuity was treated as being owned by A, with the trust as A’s agent:

Section 301.7701-4(a) of the Procedure and Administration Regulations provides that, in general, the term “trust” as used in the Code refers to an arrangement created either by a will or by an inter vivos declaration whereby trustees take title to property for the purpose of protecting or conserving it for the beneficiaries under the ordinary rules applied in chancery or probate courts. Usually, the beneficiaries of a trust do no more than accept the benefits thereof and are not the voluntary planners or creators of the trust arrangement. However, the beneficiaries may be the persons who created the trust, and the trust will be recognized as a trust under the Code if it was created for the purpose of protecting or conserving the trust property for beneficiaries who stand in the same relation to the trust as they would if the trust had been created by others for them. Generally speaking, an arrangement will be treated as a trust under the Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

Rev. Rul. 69-300, 1969-1 C.B. 167, concludes that an agreement creates a trust rather than an agency relationship if the trustee is vested with broad discretionary powers of administration and management.

United States v. Anderson, 132 F.2d 98 (6th Cir. 1942), involved the issue of whether an agreement between the taxpayer and a bank created a trust or an agency relationship. In that case, the bank could not invest or dispose of any corpus without the consent of the settlor and was relieved of all liability for any decline in the value of the corpus. The settlor had the power to vote any corporate stock held by the bank and could remove the bank and select a successor at any time. The court stated that while an agent undertakes to act on behalf of its principal and is subject to its control, a trustee usually has discretionary powers and acts for a term. Accordingly, because the bank did not have discretionary powers, the court held that the agreement created an agency relationship rather than a trust. See also City Nat'l Bank & Trust Co. v. United States, 109 F.2d 191 (7th Cir. 1940) (holding that no trust was formed where bank's investment decisions could be overridden by settlor and other evidence of managerial power was lacking).

The discretion, or lack thereof, of the trustee, was key:

Section 72(u)(1) generally provides that an annuity contract is not treated as such for federal income tax purposes (other than subchapter L) if it is held by a person who is not a natural person. The flush language of section 72(u)(1), however, provides that holding by a trust or other entity as an agent for a natural person is not taken into account for this purpose.

A trustee generally has fiduciary obligations under trust documents and governing law that are inconsistent with it acting as an agent for the beneficiary of a trust. See, e.g., Restatement (Third) of Agency section 1.01 cmt. g (2018); Restatement (Third) of Trusts section 5(e) & cmt. e (2003); Restatement (Second) of Agency section 14B (1958). This principle also applies for federal income tax purposes. See, e.g., Rev. Rul. 69-300; United States v. Anderson, 132 F.2d 98 (6th Cir. 1942). Accordingly, the phrase “as an agent” in the flush language of section 72(u)(1) pertains only to “other entity.” It does not pertain to “trust.” Thus, for purposes of section 72(u)(1), the holding of an annuity contract by a trust is not taken into account if the contract is held for a natural person.

The Trust would be the “holder” of its annuity contract within the meaning of section 72(u)(1) because the Trust would be designated in its annuity contract as the owner of the contract. The Trust is a not a grantor trust, and A is the sole beneficiary of the Trust. Thus, the Trust would be holding its annuity contract for the benefit of A. A is a natural person. Accordingly, the holding of the annuity contract by the Trust would not be taken into account for purposes of section 72(u)(1).

This determination is consistent with the purpose for adopting section 72(u). Section 72(u) was adopted to encourage employers to offer benefits to employees under qualified pension plans, which are subject to certain restrictions and generally must be made available to a wide class of employees, as opposed to offering deferred compensation to a limited class of employees that is funded by deferred annuity contacts. Because the annuity contract would not be issued in an employment context, the arrangement would not provide the sort of tax-favored benefit that section 72(u) was intended to limit.

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

## **Charitable Distributions From Trusts**

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

In Old Colony Trust Company v. Commissioner, 57 S.Ct. 813 (1937), the Supreme Court reversed a decision of the First Circuit (87 F. 2d 131). A trust document authorized but did not require the trustees to make current charitable payments if they could do so without jeopardizing the payment of annuities from the trust to non-charitable beneficiaries. The Board of Tax Appeals denied most of the income tax charitable deduction under the predecessor of § 642(c)(1) because it found that the taxpayer had not met its burden of proof regarding whether most of the payments were actually made from trust income during the year made. The First Circuit denied the entire deduction because the charitable payments were "not imperatively directed" by the trust. If the trustee exercised discretion in making the payments, they were not "pursuant to" the terms of the trust. The Supreme Court referred to the plain dictionary meaning of "pursuant to" as "acting or done in consequence or in prosecution (of anything), hence, agreeable; conformable; following; according," which standard was met by the authorization in the trust instrument.

In Crown Income Charitable Fund v. Commissioner, 8 F.3d 571, 573 (7th Cir. 1993), *aff'g* 98 T.C. 327 (1992), the Seventh Circuit addressed the issue of commutation. The trust at issue in Crown contained a provision permitting the trustees to commute the charitable interest only if, as a matter of law, it was clear that doing so would not adversely affect the maximum charitable deduction otherwise available. The trustees of the Crown Income Charitable Fund distributed trust assets in excess of the annuity amount to the charitable beneficiary over a number of years and deducted, under § 642(c), the full amount distributed to the charitable beneficiaries. Both the Seventh Circuit and the Tax Court held that the excess distributions were not deductible under § 642(c) because those instruments were not made pursuant to the terms of the governing instrument.

In Brownstone v. United States, 465 F.3d 525 (2nd Cir. 2006), a deceased husband's will created a marital deduction trust, which granted the husband's surviving wife a general testamentary power of appointment. When the wife died, she exercised her power in favor of her estate, the residue of which passed to charitable organizations. The trustee of the marital deduction trust distributed $1 million to the wife's estate and claimed a charitable contribution deduction under § 642(c), because the $1 million distribution passed entirely to the charitable beneficiaries under the wife's will.

The Second Circuit in Brownstone held that the distribution to the charities was made pursuant to the wife's power of appointment and not pursuant to the governing instrument, the deceased husband's will. The Second Circuit interpreted the definition of governing instrument narrowly, stating that an instrument subject to the creating instrument (the wife's will) could not combine with the creating instrument (the husband's will) and qualify as the governing instrument. The sole governing instrument in Brownstone was the husband's original will; therefore, the marital deduction trust was not entitled to a deduction under § 642(c) since the distribution was made pursuant to the wife's will.

\* \* \*

In Emanuelson v. United States, 159 F.Supp. 34 (D.C. Conn. 1958), decedent left two conflicting wills -- one which left 2/3 of the residue of decedent's estate to certain charities, and another which left the entire residue to non-charitable legatees. After decedent's death, a controversy arose among the beneficiaries of the two wills. The controversy was resolved in a written compromise agreement between the two sets of beneficiaries, under which 52/480 of the residue passed to the charities named in one of the wills. Payments made to the charities under the written compromise agreement were held to be made pursuant to the will. Rev. Rul. 59-15, 1959-1 C.B. 164, citing Emanuelson, held that a settlement agreement arising from a will contest qualifies as a governing instrument.

In the current case, the taxpayer makes a summary argument that the payments qualify under § 642(c) because they are pursuant to the governing instrument, citing to Old Colony. They do not address the authorities concerning deductions under modified trust instruments. Here there was no conflict with respect to Trust B subsequent to the division of Parent Trust. The trust terms were unambiguous. The purpose of the court order was not to resolve a conflict in Trust B but to obtain the economic benefits which the parties believe they will receive from the modification of the Parent Trust. Neither Rev. Rul. 59-15 nor Emanuelson hold that a modification to a governing instrument will be construed to be the governing instrument in situations where the modification does not stem from a conflict of some sort. Additionally, both Crown and Brownstone have a narrow interpretation of what qualifies as pursuant to a governing instrument. Therefore, any payments to Foundation 1 and Foundation 2 after the modification of Trust B would not be considered to be made pursuant to the governing instrument, and Trust B is not entitled to a deduction for such payments under § 642(c).

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

One standard treatise supports them on two policy grounds: "All of the courts but one [ U.S. Trust District Court] that have considered this issue have sustained these regulations, even though they substantially exceed the scope of the statutory language . . . The cases supporting the regulations take the appropriate view because a contrary rule has the effect of giving both an estate tax deduction (for the charitable disposition) and an income tax deduction (for the item distributed to charity) for the same payment. "Also, as a result of deducting distributions of corpus to charity, the non-charitable legatees in effect receive the estate's income tax-free. The benefit of the income tax deduction inures to the noncharitable legatees, rather than to the charity, so the court decisions favoring the regulation seem fundamentally sound." [citations omitted] Danforth, Robert T., et al., Federal Income Taxation of Estates and Trusts [current through 2016], at 4.07[1]

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

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

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

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

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

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

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

## **Use of Section 501(c)(4) Organizations to Facilitate Business Interest Ownership**

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

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

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

• Not a substantial contributor or foundation manager;

• Not an individual

• Not a “35 percent” corporation, partnership, trust or estate; and

• Not a private foundation.

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

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

To illustrate,

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

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

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

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

• Purchase or borrow assets from a related private foundation.

• Lease real estate to a related private foundation.

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

## **Estate Income Tax Deduction**

. Where a decedent lacks a taxable estate, but wants to make a charitable bequest, consideration should be given to providing that the first dollars of income of the estate go to charity in an amount equal to the amount of the bequest. The estate will receive an income tax deduction if the estate has sufficient income.

## **Conservation Easement Controversy**

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

The Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) are aware that some promoters are syndicating conservation easement transactions that purport to give investors the opportunity to obtain charitable contribution deductions in amounts that significantly exceed the amount invested. This [previous hit](javascript:top.docjs.prev_hit(7))notice[next hit](javascript:top.docjs.next_hit(7)) alerts taxpayers and their representatives that the transaction described in section 2 of this [previous hit](javascript:top.docjs.prev_hit(8))notice[next hit](javascript:top.docjs.next_hit(8)) is a tax avoidance transaction and identifies this transaction, and substantially similar transactions, as listed transactions for purposes of §1.6011-4(b)(2) of the Income Tax Regulations (Regulations) and §§6111 and 6112 of the Internal Revenue Code (Code).

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

An investor receives promotional materials that offer prospective investors in a pass-through entity the possibility of a charitable contribution deduction that equals or exceeds an amount that is two and one-half times the amount of the investor's investment. The promotional materials may be oral or written. For purposes of this [previous hit](javascript:top.docjs.prev_hit(11))notice[next hit](javascript:top.docjs.next_hit(11)), promotional materials include, but are not limited to, documents described in §301.6112-1(b)(3)(iii)(B) of the Regulations. The investor purchases an interest, directly or indirectly (through one or more tiers of pass-through entities), in the pass-through entity that holds real property. The pass-through entity that holds the real property contributes a conservation easement encumbering the property to a tax-exempt entity and allocates, directly or through one or more tiers of pass-through entities, a charitable contribution deduction to the investor. Following that contribution, the investor reports on his or her federal income tax return a charitable contribution deduction with respect to the conservation easement.

The effect of the Notice is retroactive:

Transactions entered into on or after January 1, 2010, that are the same as, or substantially similar to, the transaction described in section 2 of this [previous hit](javascript:top.docjs.prev_hit(12))notice[next hit](javascript:top.docjs.next_hit(12)) are identified as “listed transactions” for purposes of §1.6011-4(b)(2) and §§6111 and 6112 effective December 23, 2016. Persons entering into these transactions on or after January 1, 2010, [emphasis added] must disclose the transactions as described in §1.6011-4 for each taxable year in which the taxpayer participated in the transactions, provided that the period of limitations for assessment of tax has not ended on or before December 23, 2016.

Material advisors, including appraisers, who make a tax statement on or after January 1, 2010, with respect to transactions entered into on or after January 1, 2010, have disclosure and list maintenance obligations under §§6111 and 6112. See §§301.61113, 301.6112-1.

For rules regarding the time for providing disclosure of a transaction described in this [previous hit](javascript:top.docjs.prev_hit(13))notice[next hit](javascript:top.docjs.next_hit(13)), see §§1.6011-4(e) and 301.6111-3(e). However, if, under §1.6011-4(e)(1), a taxpayer is required to file a disclosure statement with respect to a transaction described in this [previous hit](javascript:top.docjs.prev_hit(14))notice[next hit](javascript:top.docjs.next_hit(14)) after December 23, 2016, and prior to May 1, 2017, that disclosure statement will be considered to be timely filed if the taxpayer alternatively files the disclosure with the Office of Tax Shelter Analysis by May 1 (because April 30 is a Sunday). In addition, for purposes of disclosure of transactions described in this [previous hit](javascript:top.docjs.prev_hit(15))notice[next hit](javascript:top.docjs.next_hit(15)), the 90-day period provided in §1.6011-4(e)(2)(i) is extended to 180 days. Further, if under §301.6111-3(e), a material advisor is required to file a disclosure statement with respect to the listed transaction described in this [previous hit](javascript:top.docjs.prev_hit(16))notice[next hit](javascript:top.docjs.next_hit(16)) by January 31, 2017, that disclosure statement will be considered to be timely filed if the taxpayer files the disclosure with the Office of Tax Shelter Analysis by May 1, 2017 (because April 30 is a Sunday).

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

Independently, a committee of the American Bar Association has issued a report, the ABA RPTE Conservation Easement Task Force: Recommendations Regarding Conservation Easements and Federal Tax Law. (Available via SSRN at https://ssrn.com/abstract=3385453 or 53 Real Property, Trust and Estate Law Journal, Fall 2018/Winter 2019).

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

Your letter accurately notes that the IRS believes that significant abuse of the conservation easement deduction continues to exist, particularly overvaluation of easements. Overvaluations pose a vexing and persistent problem, which the IRS addresses in Treasury Regulation section 1.170A-17 and in the syndicated conservation easement listing notice, Notice 2017-10.

The IRS has made overvalued easements an enforcement priority. IRS examiners are trained to look for overvaluation indicators, which are nearly always the primary reason for commencing a conservation easement deduction audit.

Easement donors who rely on appraisers with extensive professional qualifications and experience may in good faith believe that the appraisals they prepare contain correct conclusions of value and comport with statutory and regulatory requirements. At times, however, the reliance is misplaced. When appraisals look too good to be true, taxpayers who rely on them are taking a risk.

There are four general issues to keep an eye, two general and two specific to easements. The general issues are defective appraisals – those that don’t meet the requirements – and the failure to give income tax basis information to the IRS as required. The specific issues are the “granted in perpetuity” requirement and the “protected in perpetuity” requirement. From the perspective of policy, the IRS appears to lack confidence in appraisers, which affects its willingness to accept valuations, and in some, perhaps many, easement holders, which affects its willingness to accept a broad interpretation of the regulatory limits.

## **Granted In Perpetuity and Protected In Perpetuity Requirements**

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

The opinion states:

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

It seems clear to us that the 2006 easement does not embody “a restriction (granted in perpetuity) on the use which may be made of the real property.” See [sec. 170(h)(2)(C)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS170&originatingDoc=I2c4777600b6e11e9a1b0e6625e646f8f&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.DocLink)#co_pp_9ade0000743c1). Although the restriction placed by the easement is perpetual, “the restriction on ‘the real property’ is not.” [Belk III, 774 F.3d at 226](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=2035059776&pubNum=0000506&originatingDoc=I2c4777600b6e11e9a1b0e6625e646f8f&refType=RP&fi=co_pp_sp_506_226&originationContext=document&transitionType=DocumentItem&contextData=(sc.DocLink)#co_pp_sp_506_226) (quoting [section 170(h)(2)(C)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS170&originatingDoc=I2c4777600b6e11e9a1b0e6625e646f8f&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.DocLink)#co_pp_9ade0000743c1) ). Pine Mountain remained free to build a six-acre residential development within the 2006 Conservation Area, thus converting to commercial use land that was supposed to be protected in perpetuity from development. Indeed, it was impossible to define, when the 2006 easement was granted, what “real property” would actually be restricted from development, because the residential lots could literally be placed anywhere within the 2006 Conservation Area. As a result, the perpetual use restriction did not attach at the outset “to a defined parcel of real property” or to “a single, immutable parcel” of land. [Id. at 225, 227](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=2035059776&pubNum=0000506&originatingDoc=I2c4777600b6e11e9a1b0e6625e646f8f&refType=RP&fi=co_pp_sp_506_225&originationContext=document&transitionType=DocumentItem&contextData=(sc.DocLink)#co_pp_sp_506_225).

NALT had to approve the precise location of the six residences within the 2006 Conservation Area. By so doing, NALT might minimize the derogation of conservation values that the subdivision caused and perhaps ensure that “the conservation purpose [wa]s protected in perpetuity.” [Sec. 170(h)(5)(A)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS170&originatingDoc=I2c4777600b6e11e9a1b0e6625e646f8f&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.DocLink)#co_pp_c7a800003e633). But this does not change the fact that the easement, when granted, did not create a perpetual use restriction on a defined parcel of land, as required by [section 170(h)(2)(C)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS170&originatingDoc=I2c4777600b6e11e9a1b0e6625e646f8f&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.DocLink)#co_pp_9ade0000743c1). Because the 2006 easement does not constitute a “qualified real property interest,” Pine Mountain could not claim for the donation of this interest a charitable contribution deduction under [section 170(f)(3)(B)(iii)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS170&originatingDoc=I2c4777600b6e11e9a1b0e6625e646f8f&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.DocLink)#co_pp_78080000b9f87) and [(h)(1)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS170&originatingDoc=I2c4777600b6e11e9a1b0e6625e646f8f&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.DocLink)#co_pp_b4e500006fdf6).

2. 2005 Easement

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

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

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

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

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

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

• at least one riding stable and indoor riding ring, occupying up to ten acres in the aggregate;

• up to 14 piers and boat launches, which may include four “common boat launch facilit[ies] with associated boat storage building[s]”;

• up to five ponds, occupying up to 25 acres in the aggregate, which may apparently be encumbered by piers and boat launch facilities; and

• a reasonable (but otherwise unlimited) number of wildlife hunting stands or blinds to facilitate hunting and shooting by homeowners and their guests.

The easement does not specify the location of any of these facilities, and their location could change if the location of the Building Areas changed. Although NALT's approval is generally required, its approval for certain facilities (such as the man-made ponds) “shall not be unreasonably withheld.” For other facilities, such as the piers, boat launches, boat storage buildings, and hunting blinds, no approval or prior review by NALT is needed.

We conclude that the rights reserved to Pine Mountain, considered in their entirety, prevent the 2005 easement from constituting a “qualified real property interest.” See [sec. 170(h)(2)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS170&originatingDoc=I2c4777600b6e11e9a1b0e6625e646f8f&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.DocLink)#co_pp_1d410000745d2). As in Bosque Canyon, the easement deed allows all ten residences to be moved from the man-made lake to other, possibly more desirable, locations within the 2005 Conservation Area. And as in Bosque Canyon, the easement places no limits on how many homesites can be moved, how often this can be done, or how far into the future such relocations can occur.

The 2005 easement also permits Pine Mountain to construct, anywhere within the 2005 Conservation Area, a variety of other buildings. At least 11 of these buildings may include additional living quarters. All of these facilities are intended for the recreational use of the homeowners and their guests. Collectively, they have the effect of expanding the residential development well beyond the ten acres consumed by the Building Areas alone.

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

The Eleventh Circuit reversed in part, affirmed in part, and remanded in part, upon appeal; Pine Mountain Preserve, LLLP v. Commissioner, 978 F.3d 1200 (11th Cir. 2020). The court first held that the easements satisfy the granted-in-perpetuity requirement of section 170(h)(2)(C). The court concluded the Tax Court misunderstood the statute. The opinion states:

On its face, § 170(b)(2)(C) doesn’t require much—only that a grant embody “a restriction (granted in perpetuity) on the uses which may be made of the real property.” It seems to us clear that a conservation easement of the sort at issue here qualifies. It constitutes “a restriction” on “the use . . . of the real property” because it burdens what would otherwise be the landowner’s fee-simple enjoyment of—and absolute discretion over—the use of its property. And it does so “in perpetuity” because nothing in the grant envisions a reversion of the easement interest to the landowner, its heirs, or assigns. A broad limitation on the use of the property that applies to the parcel as a whole satisfies the statutory test, even if within that parcel there exist certain narrow exceptions to that limitation. I.R.C. § 170(h)(2)(C).

The Commissioner contends, by contrast, that an aggregate restriction on the use of the land isn’t enough; rather, he asserts, every inch of land must be subject to the restriction in perpetuity—such that, his argument goes, even a limited reservation of development rights violates the granted-in-perpetuity requirement. “[T]he whole point of § 170(h)(2)(C),” the Commissioner argues, “is to ensure that a conservation easement’s restriction on the use that may be made of the real property is *perpetual*, meaning that the restriction cannot be subsequently removed, weakened, or diminished . . . .” Br. of Appellee at 45–46 (emphasis original). But the Commissioner misunderstands both the plain language of the statute and the common-law provenance of the term “perpetuity.” As for the language, the word that precedes the term “restriction” is “a,” and it seems to us indisputable that the 2005 and 2006 easements impose “a restriction”—singular— on the uses to which the subject parcels may be put because they broadly restrict Pine Mountain’s preexisting development rights. And they impose that restriction “in perpetuity,” as that term is understood in the common law, because Pine Mountain, its heirs, or assigns remain indefinitely subject to the restriction and because nothing in the grants will cause the easements, either automatically or upon the happening of some event, to revert back to the Pine Mountain or its successors.

\* \* \*

The Tax Court constructed a “Swiss cheese” analogy—the entire conservation area serving as the slice and the development zones the holes. As the Tax Court saw it, § 170(h)(2)(C) demands that the entire slice (the conservation area) be protected from development in perpetuity, such that the landowner cannot under any circumstances relocate any of the holes (reserved rights).

But whether exceptions to restrictions in a conservation easement poke holes in the slice runs, we think, to whether the easement adequately *protects* the conservation purposes, which is a question to be answered by reference to § 170(h)(5)(A), not § 170(h)(2)(C). Using the Tax Court’s own cheese metaphor, all that § 170(h)(2)(C)’s granted-in-perpetuity condition requires is that the landowner grant a slice (*i.e.*, a restrictive easement) in the first place, which here Pine Mountain plainly did. We agree with Pine Mountain that the better cheese analogy is to Pepper Jack. Here, the reserved rights don’t introduce holes into the conservation-easement slice, because the entire slice remains subject to “a restriction”—*i.e.*, the conservation easement. Instead, the reserved rights are embedded pepper flakes, and, so long as they don’t alter the actual boundaries of the easement, § 170(h)(2)(C) is satisfied.

Importantly, the opinion distinguished the easements here from those considered by the Fourth Circuit in Belk:

In rejecting the deductions for the 2005 and 2006 easements, the Tax Court relied heavily on a series of its own previous decisions that the Fourth Circuit subsequently affirmed in *Belk v. C.I.R.*, 774 F.3d 221 (4th Cir. 2014). *Belk* concerned a conservation easement in which the landowner had reserved a right, subject to the donee organization’s approval, to “substitute an area of land . . . contiguous to the Conservation Area for an equal or lesser area of land comprising a portion of the Conservation Area.” *Belk v. C.I.R.*, 140 T.C. 1, 3 (2013), *aff'd*, 774 F.3d 221 (4th Cir. 2014). The reviewing courts held that this provision disqualified the property interest under § 170(h)(2)(C) “because the real property contributed to the Trust is not subject to a use restriction in perpetuity.” *Belk*, 774 F.3d at 226. As the Fourth Circuit interpreted that provision, “[t]he placement of the article ‘the’ before ‘real property’ makes clear that a perpetual use restriction must attach to a defined parcel of real property rather than simply *some* or *any* (or interchangeable parcels of) real property.” *Id*. at 225 (emphasis in original). It held that if the grant permits land from outside the easement to be swapped for easement land—thus freeing the easement land from the attendant restrictions— then “the restriction on ‘the real property’ is not” perpetual because the boundaries of the restricted property have shifted. *Id*. at 226.

The 2005 and 2006 easements here bear no resemblance to the one at issue in the *Belk* litigation. The easements that Pine Mountain granted only allow building areas to be moved around *within the fixed boundaries of the easement*— they don’t permit outside-territory swapping. Pine Mountain’s easements more closely resemble those in *BC Ranch II v. C.I.R.*, 867 F.3d 547 (5th Cir. 2017). In that case, landowners had deeded perpetual conservation easements to a land trust but reserved rights to build homesites on select five-acre plots, subject to the trust’s consent. The Fifth Circuit held that the easements satisfied § 170(h)(2)(C)’s granted-in-perpetuity requirement because “[o]nly discrete five-acre residential parcels, entirely within the exterior boundaries of the easement property,” could be moved within the conservation area. *Id.* at 553. In so holding, the court distinguished *Belk* on grounds that apply equally here. The Fifth Circuit explained that the problem in *Belk* arose “because the donor of the easement could develop the same land that it had promised to protect, simply by lifting the easement and moving it elsewhere,” even to “tracts of land entirely different and remote from the property originally covered by that easement”—*that*, the court recognized, is what violated the granted-in-perpetuity requirement. *Id*. at 553. The Fifth Circuit also observed that parcel-swapping would complicate valuations because an appraiser would have to value a moving target. *Id*.

By contrast, there are no such dangers where, as in *BC Ranch*—and here— an easement only permits the relocation of building areas within the conservation area without changings the easement’s boundaries. *Id*. at 552. First, such an arrangement can’t be used to release the real property from the easement in a wholesale manner. And second, so long as “the unencumbered homesite parcels have roughly the same per-acre value as the rest of the” easement territory, then appraisal is feasible because “changing the boundaries of some of the homesite parcels would not return any value to the easement donors.” *Id*. at 553.

Then the court turned to the protected-in-perpetuity requirement, which the Tax Court had upheld. The court agreed with the Tax Court:

Each easement’s amendment clause “recognize[s] that circumstances could arise which would justify the modification of certain restrictions” in the grant. The clause thus states that NALT, as the “Holder,” and Pine Mountain, as the “legal owner,” “shall mutually have the right, in their sole discretion, to agree to amendments to this Conservation Easement, which are not inconsistent with the Conservation Purposes.” The Commissioner asserts that the amendment provision gives so much discretion to the parties that it causes the 2007 easement—and again, by extension the others as well—to violate the “double-perpetuity requirement” of § 170(h)(2)(C) and § 170(h)(5)(A). We disagree. For starters, to the extent that the Commissioner’s position equates “perpetuity” with inalienability, unreleasability, or unamendability, we reject it. As we have explained, “perpetuity”—as used in connection with conservation easements—draws on the term’s common-law meaning and denotes only that the granted property won’t automatically revert to the grantor, his heirs, or assigns. *See supra* at 12–13.

Separately, it seems to us that the Commissioner’s position proves entirely too much. Parties to a bilateral contract—which is all a conservation easement is—can *always* agree after the fact to amend their agreement, whether or not they expressly reserve that right to themselves in writing. If the possibility of amendment were a deal-killer, then there could be no such thing as a tax deductible conservation easement.

As the Tax Court correctly observed, the easements at issue here are conveyances with respect to which Pine Mountain and NALT contracted. It is (literally) hornbook contract law that contracting parties are free to amend their agreements after the fact. *See* 28 Williston on Contracts § 70:154 (4th ed.) (“A promise modifying a duty under an executory contract is binding if the modification is fair and equitable in view of circumstances not anticipated by the parties when the contract was made.”); *see also* Restatement (Second) of Contracts § 89 (1981) (similar). More particularly, traditional servitude doctrine has long allowed for the amendment of easements. *See* Restatement (Third) of Property (Servitudes) § 7.1 (2000) (observing that a property servitude “may be modified or terminated by agreement of the parties, pursuant to its terms”). 5 And indeed, even the Uniform Conservation Easement Act—the act that enabled landowners to grant perpetual easements to conservation trusts—provides for the possibility of bilateral amendments. *See* UCEA § 2(a) (“Except as otherwise provided . . . , a conservation easement may be created, conveyed, recorded, assigned, released, *modified*, terminated, or otherwise *altered* or affected in the same manner as other easements.” (emphasis added)).

The essence of the Eleventh Circuit’s policy determination – if court’s make policy determinations – is in footnote 4, to which the careful listener can almost hear the IRS replying “no, no, no, are you crazy?”

4 Lest anyone worry that our interpretation of § 170(h)(2)(C) gives the Pine Mountains of the world a free pass, we make two observations in closing our discussion of the 2005 and 2006 easements. First, we have dealt only with § 170(h)(2)(C). Even after passing through the granted-in-perpetuity gateway, a conservation easement must still satisfy § 170(h)(5)(A)’s protected-in-perpetuity requirement; that, it seems to us, is likely where Congress envisioned the heavy lifting—the more rigorous analysis of the degree to which the grant protects conservation purposes—should occur. Second, recall that NALT has extensive advance-approval rights under these easement contracts. NALT is a sophisticated land-conservation organization, and we have little doubt that when it comes to negotiating conservation easements, it is well positioned and equipped to look after conservation interests.

Finally, the court remanded for a “better” determination of value from the Tax Court. The court thought the original decision just “split the baby” which was inappropriate.

## **Judicial Extinguishment**

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

For an easement of the sort involved here, a charitable contribution deduction is allowable only if the underlying conservation purpose is “protected in perpetuity.” Sec. 170(h)(5)(A); see Coal Prop. Holdings, 153 T.C. at 135. The regulations set forth detailed rules for determining whether this “protected in perpetuity” requirement is met. See sec. 1.170A-14(g), Income Tax Regs.

The rules governing “judicial extinguishment” appear in section 1.170A-14(g)(6), Income Tax Regs. It provides that the donor must agree that the easement gives rise to a property right in the donee having a FMV “that is at least equal to the proportionate value that the \* \* \* [easement] at the time of the gift, bears to the value of the property as whole at that time.” Id. subdiv. (ii) (emphasis added). In the event of a sale following judicial extinguishment of the easement, the donee “must be entitled to a portion of the proceeds at least equal to that proportionate value.” Ibid. “In effect, the ‘perpetuity’ requirement is deemed satisfied because the sale proceeds replace the easement as an asset deployed by the donee ‘exclusively for conservation purposes.’ ” Coal Prop. Holdings, 153 T.C. at 136(quoting section 170(h)(5)(A)).

The regulation requires, in short, that the donee receive a proportionate share of the sale proceeds, as determined by the fraction set forth in the regulation.[3](https://1.next.westlaw.com/Document/I04deac80959111ea8cb395d22c142a61/View/FullText.html?transitionType=UniqueDocItem&contextData=(sc.UserEnteredCitation)&userEnteredCitation=t.c.+memo.+2020-55#co_footnote_B00032050955580) The easement deed in this case does not satisfy this requirement. The deed defines the donee’s share of the sale proceeds as the FMV of the easement, determined “as of the date of this Conservation Easement.” The donee’s share is thus restricted to “a date-of-gift value that would exclude subsequent appreciation.” R.R. Holdings, at \*13. The donee would accordingly “watch its proportion of potential extinguishment proceeds shrink over the years if the underlying property appreciates.” Ibid. This shrinking value does not equal the “proportionate value” of the sale proceeds that the regulation mandates that the donee receive.

The court notes other similar cases:

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

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

In Sells v. Commissioner, T.C. Memo. 2021-12, the court concluded the taxpayer had reasonable cause when using a “defective” extinguishment clause because of PLR 200836014 which had approved a similar clause and because the court found similar clauses were in widespread use, including by the easement holder.

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

The two aspects of the “judicial extinguishment” rule to which petitioner objects are the requirement that the donee receive a proportional share of the proceeds and the fact that the “proportionate share” formula does not account for the possibility of donor improvements. Treasury clearly considered the comments it received on the first point because it substantially revised the text of section 1.170A-14(g)(6)(ii), Income Tax Regs., in response to those comments. See supra pp. 14-15.

Only one of the 90 commenters mentioned donor improvements, and it devoted exactly one paragraph to this subject. That commenter, NYLC, was concerned about facade easements on historic structures, as opposed to “perpetual open space easements,” with which Treasury was chiefly concerned. See 48 Fed. Reg. at 22940. And NYLC mentioned this point to support its belief that donors of facade easements “are likely to be discouraged from making a donation,” a sup-position that Treasury may reasonably have discounted.

In any event, “[t]he administrative record reflects that no substantive alternatives to the final rules were presented for Treasury’s consideration.” SIH Partners, 150 T.C. at 44; see dissenting op. p. 102 (“A comment is \* \* \* more likely to be significant if the commenter suggests a remedy for the purported problem it identifies.”). NYLC offered no suggestion about how the subject of donor improvements might be handled; it simply recommended “deletion of the entire extinguishment provision.” Only one other commenter of the 13 mentioning judicial extinguishment voiced that recommendation.

Footnote 3, relevant to the dissent, states:

Our dissenting colleague errs in relying on United States v. Nova Scotia Food Prods. Corp., 568 F.2d 240 (2d Cir. 1977), to support his position. See dissenting op. pp. 110-113. That case involved a Food and Drug Administration (FDA) regulation establishing minimum “time, temperature, and salinity” requirements for processing fish. The Second Circuit invalidated the regulation as applied to one category of fish product, “non-vacuum-packed hot-smoked white-fish.” Nova Scotia Food Prods. Corp., 568 F.2d at 253. The court first held that the FDA had “failed to disclose to interested parties the scientific data and the methodology upon which it relied.” Id. at 250. “When the basis for a proposed rule is a scientific decision, the scientific material which is believed to support the rule should be exposed to the view of interested parties for their comment.” Id. at 252. The court also held that the agency had failed to consider: (1) evidence that heating “certain types of fish to high temperatures will completely destroy the product,” (2) the suggestion that using “nitrite and salt as additives could safely lower the high temperature otherwise required,” and (3) the suggestion that different processing requirements should be established for different species of fish. Id. at 245. Here, the basis for the proposed regulation was not “a scientific decision”; Treasury relied on no undisclosed data when proposing its regulation; the two commenters who opposed the judicial extinguishment rule offered no concrete alternative suggestions; and the concerns they expressed lacked the significance of concerns about destroying the commercial viability of a product, which the Second Circuit aptly described as “vital questions” in Nova Scotia Food Prods. Corp., 568 F.2d at 252.

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The broad statements of purpose contained in the preambles to the final and proposed regulations, coupled with obvious inferences drawn from the regulations themselves, are more than adequate to enable us to perform judicial review. We find that Treasury’s rationale for the judicial extinguishment rule “can reasonably be discerned and \* \* \* coincides with the agency’s authority and obligations under the relevant statute.” SIH Partners, 150 T.C. at 47. We accordingly hold that Treasury satisfied all applicable APA requirements when promulgating this rule.

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

Having concluded that the regulation was properly promulgated, we turn to petitioner’s contention that the regulation is substantively invalid. When considering a challenge to the substantive validity of a regulation, we generally employ the two-part test established by Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc., 467 U.S. 837 (1984). The first prong of that test asks “whether Congress has directly spoken to the precise question at issue.” Id. at 842. “If the intent of Congress is clear, that is the end of the matter.” Ibid.

Section 170(h)(5)(A) sets forth a general requirement that the conservation purpose be “protected in perpetuity.” Congress does not appear to have considered the possibility that an easement might be judicially extinguished, and the statute does not address how that possibility would affect a taxpayer’s ability to satisfy the “perpetuity” requirement. Congress therefore did not speak directly to the question at issue.

We accordingly proceed to Chevron step two, which requires us to consider whether the regulation “is based on a permissible construction of the statute.” Chevron, 467 U.S. at 843. If the statute is silent, we must give deference to the interpretation embodied in the agency’s regulation unless it is “arbitrary, capricious, or manifestly contrary to the statute.” [Id. at 844](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1984130736&pubNum=0000780&originatingDoc=Ic1eca89094e711ea8cb395d22c142a61&refType=RP&fi=co_pp_sp_780_844&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_780_844); see United States v. MeadCorp., 533 U.S. 218, 227 (2001). In other words we must sustain the regulation so long as it represents a “reasonable interpretation” of the law Congress enacted. Chevron, 467 U.S. at 844; see SIH Partners, 150 T.C. at 50.

The court determined that the regulation was valid under Chevron:

We cannot say that the regulation’s “proportionate value” approach is “arbitrary, capricious, or manifestly contrary to the statute.” Chevron, 467 U.S. at 844. Under the regulation the donee acquires “a property right, immediately vested in the donee organization,” in a share of any future proceeds. Sec. 1.170A-14(g)(6)(ii), Income Tax Regs. Needless to say, the easement might be extinguished many years after it was granted, and considerable inflation in property values might occur in the interim. If the donee’s share were limited to the easement’s historical FMV, its property right could be eviscerated in real dollar terms. This would allow the donor or its successors to “reap[ ] a windfall if the property is destroyed or condemned.” Carroll, 146 T.C. at 214 (quoting Kaufman, 687 F.3d at 26). That outcome would be at odds with the regulation’s central purpose: to ensure satisfaction of the statute’s “protected in perpetuity” requirement by supplying the donee with an asset that replaces, in real terms, the easement that has been lost.

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Second, petitioner contends that the regulation is invalid because it does not permit the donee’s share of the proceeds to be reduced by the value of improvements (if any) made by the donor. The regulation as proposed did not address donor improvements, and only one of 90 commenters mentioned the point. See supra pp. 21-22. Once again, we cannot say that the absence of a provision addressing donor improvements renders the regulation “arbitrary, capricious, or manifestly contrary to the statute.” Chevron, 467 U.S. at 844.

Treasury’s goal in prescribing this regulation was to ensure satisfaction of the statute’s “protected in perpetuity” requirement. In effect this requirement is deemed satisfied because the sale proceeds replace the easement as an asset deployed by the donee “exclusively for conservation purposes.” Sec. 170(h)(5)(A). In certain factual scenarios, reducing the donee’s proceeds on account of donor improvements could frustrate this goal, especially if local land values should decline.

For example, assume that a taxpayer donates an easement valued at $1 million on property valued at $2 million without the easement. The taxpayer thereafter spends $1 million improving the property. Many years later, there is an economic downturn, the easement is extinguished, and the property is sold for $2 million. Under the regulation the donee would be entitled to $1 million (half of the proceeds) and the conservation purpose would be deemed “protected in perpetuity.” Sec. 170(h)(5)(A). But if improvements were carved out, the donee’s share would be reduced to $500,000 or zero, depending on whether the carve-out was applied to the entire proceeds or to the donee’s 50% share.

NYLC, the only commenter to mention donor improvements, notably did not suggest any text to address this problem. And addressing it would have raised a host of questions: Would the donee’s proceeds be reduced by improvements the donor had made before granting the easement, after granting it, or both? Would the donor get credit for improvements to the land itself (such as grading) or only for erecting structures? Would the donee’s proceeds be reduced by the donor’s cost for the improvements or by their FMV at the time the easement was extinguished? And how would the problem mentioned in the previous paragraph be solved, to prevent the donee’s share from being severely reduced or even eliminated? It is conceivable that Treasury could have drafted a regulation that addressed the possibility of donor improvements, dealing with these ancillary questions in some rational way. But that was a policy decision for Treasury, not this Court, to make.

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

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

[footnote omitted]

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

Oakbrook maintains that the requirement of section 170(h)(5)(A) is met so long as the donee, upon a sale or other disposition after extinguishment by judicial proceeding, would obtain an amount equal to the fair market value of the easement at the time the easement was established, subject to reduction for subsequent improvements funded exclusively by the donor.[3](https://1.next.westlaw.com/Document/Ic1eca89094e711ea8cb395d22c142a61/View/FullText.html?transitionType=UniqueDocItem&contextData=(sc.UserEnteredCitation)&userEnteredCitation=154+t.c.+no.+10#co_footnote_B00082050952136) But Oakbrook’s position ignores the fact that, to be eligible for a deduction under section 170(h) in the first place, a donor must grant to a donee an “interest[ ] in real property.” Sec. 170(h)(2). One of the rights inherent in a real property interest (and presumably required to be transferred to the donee in order to satisfy section 170(h)(2)(C)) is the property holder’s right to be compensated at fair market value upon a subsequent transfer or taking.

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The formula set out in the Deed exposes the fundamental problem for Oakbrook-under the terms of the Deed, the donee never received the type of “interest[ ] in real property” contemplated by section 170(h)(2)(C) and further protected by section 170(h)(5)(A). Put another way, by failing to convey to the donee the unrestricted right to be compensated at fair market value upon a future transfer or taking, the Deed so restricted the donee’s interest as to cause it to fall outside the purview of section 170(h)(2)(C).

The shortcoming inherent in the Deed also affects Oakbrook’s compliance with section 170(h)(5)(A). The payment of a predetermined fixed amount would be insufficient as compensation for a right “protected in perpetuity” if the fair market value of the property had appreciated since the date the easement was granted. When a transfer of money to the donee is intended to satisfy the “perpetuity of purpose” requirement of section 170(h)(5)(A), no reasonable reading of the statute would bless the donee receiving an amount that is less than the fair market value of its “interest[ ] in real property” as of the time of the conversion of its interest into cash.

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

I begin at the same starting place--the statutory text. The statute provides a deduction for a contribution to a qualified organization of a “qualified real property interest” made “exclusively for conservation purposes.” Although the statute makes clear that there can be no deduction unless the conservation purposes are “protected in perpetuity,” one cannot lose track of the fact that the deduction is predicated on a “qualified real property interest” being contributed to a qualified organization. Thus, the most that a qualified organization can be entitled to receive if its “qualified real property interest” is extinguished in the future is the full value of that interest. Whatever the purpose of a contribution, that purpose may not be invoked to require the donor to give the donee, as a precondition to receiving a deduction for his contribution, a right to receive compensation properly attributed to the real property interest that the Code permits the donor to retain. A regulation interpreted to require otherwise cannot be a permissible interpretation of the statutory text before us. Under that text, the interest the donee organization must obtain in connection with a contribution is the “qualified real property interest” transferred to it. Requiring the donor to promise to turn over to the donee proceeds in excess of the fair market value of that interest is inconsistent with the statutory framework, and nothing in the “statutory purposes” compels a different conclusion. Goldstein, 451 F.3d at 881 (quoting Abbott Labs., 920 F.2d at 988).

The opinion of the Court admits that “[i]t is conceivable that Treasury could have drafted a regulation that addressed the possibility of donor improvements, dealing with [the types of questions noted above] in some rational way.” See op. Ct. p. 30. But the opinion of the Court overlooks the lack of a “rational” solution to those problems, by noting that “that was a policy decision for Treasury, not this Court, to make.” See id. In the Court’s view, “Treasury’s overarching goal [in prescribing the regulation] was to guarantee that the donee, upon judicial extinguishment of the easement, would receive the full share of proceeds to which it was entitled. \* \* \* Treasury exercised reasoned judgment by adhering to a simple rule that splits sale proceeds in a direct proportional manner.” See id. p. 31.

I agree with the opinion of the Court that the donee should “receive the full share of proceeds to which it was entitled.” See id.(emphasis added). But a rule interpreted to require the deed to allocate to the donee not only the proceeds attributable to its own real property interest but also a share of the proceeds attributable to the interest the Code permits the donor to retain does not “ ‘ “fit” ’ with the statutory language” and is unreasonable. Good Fortune Shipping SA v. Commissioner, 897 F.3d at 262 (quoting Goldstein, 451 F.3d at 881). Calling it a “policy decision” does not change the fact that the rule, as interpreted by the Commissioner, yields in certain circumstances a result that is entirely unreasonable and without any basis in the statute. Under Chevron, Treasury is entitled to draw lines on the page provided by Congress; Chevron does not give Treasury legislative authority to substitute a different page for the one Congress enacted into law.

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

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

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

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

But, in my view, Treasury did not think it confronted such a Herculean task. It is more likely that Treasury was simply following its historical position that the APA’s procedural requirements did not apply to these types of regulations.[15](https://1.next.westlaw.com/Document/Ic1eca89094e711ea8cb395d22c142a61/View/FullText.html?transitionType=UniqueDocItem&contextData=(sc.UserEnteredCitation)&userEnteredCitation=154+t.c.+no.+10#co_footnote_B00202050952136) As the Treasury Decision explains, Treasury took the view that “[a]lthough a notice of proposed rulemaking which solicited public comments was issued, the \* \* \* [IRS] concluded when the notice was issued that the regulations are interpretative and that the notice and public comment procedure requirement of 5 U.S.C. 553 did not apply.” T.D. 8069, 1986-1 C.B. at 92. When an agency engaged in a particular rulemaking exercise believes the APA does not require it to provide notice and receive comments at all, it is not difficult to see why that agency might think that a rather brief explanation, offered as it were out of its own generosity, should be good enough.[17](https://1.next.westlaw.com/Document/Ic1eca89094e711ea8cb395d22c142a61/View/FullText.html?transitionType=UniqueDocItem&contextData=(sc.UserEnteredCitation)&userEnteredCitation=154+t.c.+no.+10#co_footnote_B00222050952136)

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

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The NYLC Comment Letter in effect countered that the proposed rule on future donor improvements was contrary to those policy decisions, would lead to inequitable results that were inconsistent with the statute, and would deter future contributions. In short, the NYLC Comment Letter offered comments that, “if adopted, would require a change in an agency’s proposed rule.” Home Box Office, 567 F.2d at 35 n.58. Those comments were both “relevant and significant,” requiring a response. Grand Canyon, 154 F.3d at 468; accord Carlson, 938 F.3d at 343-344.

Unfortunately, however, the Treasury Decision finalizing the regulations contains no such response. The Treasury Decision changed the sentence on which the Commissioner relies with respect to donor improvements as follows (with the relevant change underscored):

(1) Proposed Regulation: “For purposes of this paragraph (g)(5)(ii), that original minimum proportionate value of the donee’s property rights shall remain constant.” 48 Fed. Reg. 22946.

(2) Final Regulation: “For purposes of this paragraph (g)(6)(ii), that proportionate value of the donee’s property rights shall remain constant.” T.D. 8069, 1986-1 C.B. at 99.

But Treasury gave no explanation as to how the change addressed the concerns expressed in the NYLC Comment Letter. In short, Treasury’s actions did not provide “an explanation [that] is clear enough that its ‘path may reasonably be discerned.’ ” Encino Motorcars, 579 U.S. at \_\_\_, 136 S. Ct. at 2125 (quoting Bowman Transp., 419 U.S. at 286).[18](https://1.next.westlaw.com/Document/Ic1eca89094e711ea8cb395d22c142a61/View/FullText.html?transitionType=UniqueDocItem&contextData=(sc.UserEnteredCitation)&userEnteredCitation=154+t.c.+no.+10#co_footnote_B00232050952136) Nor does Treasury’s action provide any insight on “what major issues of policy were ventilated ... and why the agency reacted to them as it did” on this point. Carlson, 938 F.3d at 344 (quoting Del. Dep’t of Nat. Res. & Envtl. Control, 785 F.3d at 17).

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

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

What we hear is the chirping of crickets.

The Final Rule’s statement of basis and purpose shows absolutely no mention of the extinguishment-proceeds clause at all, much less any mention of the proportionate-share or improvements problems--and no reasoned response to any of the public’s comments on those provisions.[9](https://1.next.westlaw.com/Document/Ic1eca89094e711ea8cb395d22c142a61/View/FullText.html?transitionType=UniqueDocItem&contextData=(sc.UserEnteredCitation)&userEnteredCitation=154+t.c.+no.+10#co_footnote_B00362050952136) The majority doesn’t deny this, see op. Ct. pp. 23-25, and we aren’t even the first court to notice: In Kaufman v. Shulman, 687 F.3d 21, 26 (1st Cir. 2012), the First Circuit was forced to guess at the apparent purpose of the section 1.170A-14(g)(6)(ii), Income Tax Regs., after noting that it “was unexplained when first promulgated.”

This makes the defining characteristic of section 1.170A-14(g)(6)(ii), Income Tax Regs., its utter lack of any contemporaneous explanation of its key choices--to require that donees get a fraction, rather than an absolute amount, of extinguishment proceeds and to require that they get a share of any proceeds from a donor’s improvements to the property. There is no prefiguring of these choices in the legislative history or the notice of proposed rulemaking, and no explanation of them in the Final Rule. Had Treasury responded in any meaningful way to the comments that it received, such as those from the NYLC, neither donors and donees, nor courts, see, e.g., Oakbrook, T.C. Memo. 2020-54, at \*20-\*28 (highlighting the confusing nature of section 1.170A-14(g)(6), Income Tax Regs., and attempting to discern its meaning), nor the IRS, compare Priv. Ltr. Rul. 200836014 (Sept. 5, 2008) (stating that the regulation isn’t violated by a conservation easement in which a donee receives only proceeds less any amount attributable to an improvement), with Oakbrook, T.C. Memo. 2020-54, at \*36 (addressing the IRS’s argument that a conservation easement in which a donee receives only proceeds less any amount attributable to an improvement is a violation of the regulation), would have to grapple with whether “proportionate value” establishes a fraction or a fixed value, or whether a donee is entitled to any extinguishment proceeds attributable to the value of improvements or rising land values. Such widespread industry confusion is precisely what APA section 553 is intended to avoid. So while we don’t demand a perfect explanation for Treasury’s decision making, see Bowman Transp., 419 U.S. at 286, we should demand some, see Encino Motorcars, 579 U.S. at \_\_, 136 S. Ct. at 2125. And here, there wasn’t any.

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

These seem like perfectly plausible reasons. But they are not the ones that Treasury itself offered at the time it issued the regulation. This raises another problem for the Commissioner in his defense--the Chenery rule. The Chenery rule prevents an agency from relying on post hoc rationalizations to defend its decision making. SEC v. Chenery Corp., 318 U.S. 80, 87 (1943) (“The grounds upon which an administrative order must be judged are those upon which the record discloses that its action was based.”); see also State Farm, 463 U.S. at 50 (courts may not accept post hoc rationalizations). And Chevron step 2 is limited by Chenery. Bank of Am., N.A. v. FDIC, 244 F.3d 1309, 1319 (11th Cir. 2001) (stating that Chenery must be considered at step 2 of Chevron); see also Council for Urological Interests v. Burwell, 790 F.3d 212, 222 (D.C. Cir. 2015); America’s Cmty. Bankers v. FDIC, 200 F.3d 822, 835 (D.C. Cir. 2000). We shouldn’t be coming up with our own post hoc justifications for the reasonableness of the rule if the Commissioner’s lawyers wouldn’t be able to.

The same problem affects our analysis of the substantive validity of this regulation under State Farm. The Sixth Circuit has warned agencies that its arguments in favor of a regulation not being “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law” is likewise limited by the Chenery rule. See Atrium, 766 F.3d at 567-68 (“[T]he ground upon which an administrative order must be judged are those upon which the record discloses that its action was based.” (quoting Chenery, 318 U.S. at 87)).

The majority today comes up with as good a set of arguments as possible to justify the reasonableness of the regulatory choices that Treasury made when it was drafting this regulation. But Treasury didn’t make them. Or at least it didn’t make them in the administrative record of this regulation.

The Eleventh Circuit in Tot Property Holdings, LLC v. Commissioner, 2021 WL 2559088 (11th Cir. 2021) upheld the Tax Court’s determination that a savings clause in the easement deed could not save the deduction. The opinion states:

Section 9 of the deed governs extinguishment and condemnation of the easement. Section 9.1, the extinguishment section, states:

If circumstances arise in the future that render the purpose of this Easement impossible to accomplish, the Easement can only be terminated or extinguished, whether in whole or in part, by judicial proceedings in a court of competent jurisdiction. The amount of the proceeds to which Grantee shall be entitled from any sale, exchange, or involuntary conversion of all or any portion of the Property subsequent to such termination or extinguishment, shall be the stipulated fair market value of this Easement, or proportionate part thereof, as determined in accordance with Section 9.2 or 26 C.F.R. Section 1.170A-14, if different.

Section 9.2 of the deed is entitled “Valuation.” The easement is a real property interest immediately vested in Foothills. According to Sections 9.1 and 9.2, the stipulated fair market value of the easement at the time of such future extinguishment (which will determine the “amount of the proceeds to which Grantee shall be entitled”) shall be determined by (as stated in Section 9.2):

multiplying (a) the fair market value of the Property unencumbered by this Easement (minus any increase in value after the date of this grant attributable to improvements) by (b) a fraction, the numerator of which is the value of this Easement at the time of the grant and the denominator of which is the value of the Property without deduction of the value of this Easement at the time of this grant.

In other words, this Section 9.2 formula provides that, upon any such future extinguishment (e.g. condemnation), the proceeds (e.g. proceeds of the condemnation) shall be reduced by “any increase in value after the date of this grant attributable to improvements,” and then the charitable donee's share would be determined by multiplying that reduced amount times the defined fraction. And the numerator and denominator of the fraction are the value, respectively, of the easement and unencumbered property at the time of the grant. Section 9.2 then concludes as follows: “It is intended that this Section 9.2 be interpreted to adhere to and be consistent with 26 C.F.R. Section 1.170A-14(g)(6)(ii).”

\* \* \*

The dispositive question for whether the taxpayer may claim a deduction in this case is whether the Treasury Regulation Override provisions in Section 9 of the easement deed are impermissible savings clauses that are triggered by a condition subsequent, on the one hand, or valid interpretive provisions, on the other. If the former, the deed is not in compliance with 26 C.F.R. § 1.170A-14, no deduction can be claimed, and we must affirm the Tax Court on this issue. If the latter, it is at least arguable that the deed complies.

\* \* \*

Appellants attempt to circumvent the problem of inconsistency of Section 9.2 with the requirements of the regulation, and the resulting disallowance of their deduction, by relying on the Treasury Regulation Override provisions of Sections 9.1 and 9.2. They argue that, pursuant to those provisions, the amount of the proceeds to which Foothills is entitled shall be “determined in accordance with Section 9.2 or 26 C.F.R Section 1.170A-14, if different,” and “[i]t is intended that this Section 9.2 be interpreted to adhere to and be consistent with 26 C.F.R. Section 1.170A-14(g)(6)(ii).” Appellants' argument is that these provisions are interpretive tools that operate to require proceeds to be distributed in compliance with 26 C.F.R § 1.170A-14. Because the formula in Section 9.2—the preferred alternative to applying § 1.170A-14, according to the deed—is, in fact, “different” from the regulatory formula and the deed requires the regulations to always control, TOT argues that we must interpret the deed to comply with the regulation.

TOT argues that the Tax Court erred in holding that the Treasury Regulation Override provisions were not interpretive and contained a “condition subsequent savings clause.” Whether the donation of the conservation easement is deductible, thus, turns on whether the Override provisions in the easement deed are unenforceable savings clauses, rather than valid interpretive provisions. We turn next to discuss the distinction between a condition subsequent savings clause, on the one hand, and a merely interpretive clause on the other hand.

The court concluded the clause in question is a condition-subsequent savings clause:

First, the formula in Section 9.2 of the easement deed is unambiguous. It plainly and unambiguously provides that the required fraction, or proportionate share, shall be applied to the sales proceeds “minus any increase in value after the date of th[e] grant attributable to improvements.” Juxtaposed against the deed's alternative formula—that in 26 C.F.R. § 1.170A-14(g)(6)(ii)—Section 9.2's subtraction of the value of property improvements is stark. As in Belk, therefore, “[t]here is no open interpretive question for the savings clause to ‘help’ clarify.” 774 F.3d at 230. Rather, Section 9.2 unambiguously provides that the value attributable to improvements will be subtracted from condemnation proceeds before the required fraction is applied.

Second, the operation of the Treasury Regulation Override provisions in this case means that the preferred formula—expressly described in the easement deed in Section 9.2—is simply nullified. Again, Section 9.1 defines the fair market value of Foothills's proceeds “as determined in accordance with Section 9.2 or 26 C.F.R Section 1.170A-14, if different.” Thus, Section 9.1 clearly states that Section 9.2's formula applies; it is first in the provision and has no condition attached to it. Then, the provision continues to contemplate the regulation's application, but its application is conditional. That is, the application of the regulation is conditioned on whether it is “different” from the plain text of the express formula in the easement deed in Section 9.2. If it is “different,” the Override operates to simply rewrite the easement deed to eliminate the Section 9.2 formula, leaving operative only the regulatory formula. If enforced, then, the Override would then impermissibly “countermand the plain text of the [e]asement [d]eed.” Coal Prop., 153 T.C. at 141; e.g., Belk, 774 F.3d at 230 (“Thus, the Belks ask us to employ their savings clause not to aid in determining [their] intent, but to rewrite their Easement in response to our holding. This we will not do.” (internal quotation marks omitted) (citation omitted)).

Third, for the Override to be triggered and for the regulation to apply as the proper formula over Section 9.2's formula, a future event must occur, i.e. a determination that the proper interpretation of the regulation is “different” from the formula set forth in Section 9.2. And, in this sense, Foothills's property right to proceeds “equal to the [regulatory] proportionate value” is not “immediately vested,” 26 C.F.R. § 1.170A-14(g)(6)(ii), as the regulation requires, since the defined right to proceeds—without improvements subtracted out—is conditioned on a subsequent IRS or court determination.

An IRS Chief Counsel’s Memorandum released July 30, 2021, CCA 202130014, sets forth the government position and offers satisfactory language for easements to adopt on the extinguishment issue. The CCA states:

ISSUE

Does a conservation easement fail to satisfy the requirements of section 170(h) of the Code if the deed contains language subtracting from the donee’s extinguishment proceeds the value of post-donation improvements or the post-donation increase in value of the property attributable to improvements?

CONCLUSION

Yes. Decreasing the portion of the proceeds that is required to be allocated to the donee upon extinguishment under Treas. Reg. § 1.170A-14(g)(6)(ii) causes the easement to fail to satisfy the requirements of section 170(h) unless, as provided in Treas. Reg. § 1.170A-14(g)(6)(ii), state law provides that the donor is entitled to the full proceeds from the conversion.

The CCA goes on to set forth appropriate language:

Donor agrees that the donation of the perpetual conservation restriction described in this deed gives rise to a property right, immediately vested in the donee organization, with a fair market value that is at least equal to the proportionate value that the perpetual conservation restriction, at the time of the gift, bears to the fair market value of the property as a whole at that time. For purposes of this paragraph, the proportionate value of the donee organization's property rights shall remain constant.

On a subsequent sale, exchange, or involuntary conversion of the subject property, the donee organization will be entitled to a portion of the proceeds at least equal to that proportionate value of the perpetual conservation restriction.

All of the donee organization’s proceeds from a subsequent sale or exchange of the property must be used by the donee organization in a manner consistent with the conservation purposes of the original contribution.

## **Golf Course Does Not Automatically Invalidate Conservation Easement Deduction**

. The Eleventh Circuit in Champions Retreat Golf Founders v. Commissioner, 2020 WL 2462534 (11th Cir. 2020) summarized the case as follows:

The appellant taxpayer claimed a charitable deduction for donating a conservation easement over property that included a private golf course and undeveloped land. The Commissioner of Internal Revenue disallowed the deduction, and the Tax Court upheld the decision. The deduction was proper if the donation was made for “the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem,” or was made for “the preservation of open space . . . for the scenic enjoyment of the general public.” I.R.C. § 170(h)(4)(A)(ii) & (iii)(I).

Without the golf course, this easement would easily meet these criteria. Because the Code does not disqualify an easement just because it includes a golf course, we reverse the Tax Court's decision and remand for determination of the proper amount of the deduction.

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

The Commissioner's expert takes no issue with the proposition that many birds use the property including some that are worthy of protection. He says, though, that the habitat itself is not relatively natural. For this he focuses on the fairways and greens — they consist of non-native bermuda and bent grass — not the undeveloped portion of the easement, which is, at least for the most part, quite natural.

What matters under the Code and regulation is not so much whether all the land is natural, but whether the habitat is natural. Indeed, the regulation says it is not disqualifying that the land has been altered, so long as “the fish, wildlife, or plants continue to exist there in a relatively natural state.” 26 C.F.R. § 1.170A-14(d)(3)(i). The Commissioner's expert noted nothing unnatural about these birds' existence; they apparently find the habitat quite suitable.

Champions also cites the property's population of southern fox squirrels — a species for which the habitat, including the golf course, is hospitable. The species is not threatened but has suffered declines caused by diminishing habitat, due in part to forest-management practices. The Commissioner discounts the importance of the species, noting that Georgia has a six-month season in which hunters may take up to 12 squirrels per day. But that is not dispositive of the question whether providing the squirrels a habitat is a conservation purpose. That Georgia chooses not to protect the species hardly seems a reason to deny whatever protection is available under federal law. Protecting fox squirrels would not alone be sufficient to establish a conservation purpose, but they add to the weight on Champions' side of the scale.

Finally, while the golf course itself is comprised primarily of non-native grasses, the remainder of the easement property is natural and includes a rare species of plant, the denseflower knotweed. The Commissioner has offered no theory under which protecting the denseflower knotweed is not an appropriate conservation purpose.

It is true, as the Commissioner notes, that the knotweed exists on only a limited proportion of the easement — perhaps 7%, with the capacity to occupy up to 17%. But the knotweed that exists, whatever its proportion, is worthy of protection.

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

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

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

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

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

The concerned land is also scenic, notes the court:

The record establishes without dispute that members of the public can and do canoe and kayak on the Savannah River alongside the easement and on the Little River as it runs through the easement. The view from the rivers includes the easement's natural areas as well as the golf course. The record includes a video illustrating the stark difference in the views of the easement property, on the one hand, and the property farther down the Savannah River, on the other. The downriver property includes considerable development — development that few canoers or kayakers would find scenic.

One could perhaps debate whether a golf course provides scenic enjoyment. But the natural areas covered by this easement surely do. And the golf course, whose most prominent feature visible from a canoe or kayak on the river is the trees, detracts only a little, if at all. When compared to a condominium building or even private homes, the easement property qualifies as open space providing scenic enjoyment. And preserving relatively natural views along these two rivers — views free of development on the other side as well because of the national forest — serves a public interest.

In asserting the contrary, the Commissioner says the rivers' banks are from three to ten feet high, as if this somehow eliminates the opportunity for scenic enjoyment. The Tax Court took the same approach. But trees, on the one hand, and condos or other buildings, on the other hand, can be seen from a canoe or kayak, even when a river's banks are ten feet high. Indeed, if a ten-foot bank obscures anything, it is the fairways and greens and other non-natural features of a golf course, not the trees. From a kayak on a river with a ten-foot bank, the flat parts of a golf course look just like open land. The notion that the banks somehow prevent scenic enjoyment is a makeweight.

Were it not for the presence of a golf course on part of this property, the assertion that preserving open space alongside rivers with three- to ten-foot banks cannot be “for the scenic enjoyment of the general public” and provide a public benefit would be a nonstarter.

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

*Second,* in my view, Champions' easement might not be a “relatively natural habitat.” I.R.C. § 170(h)(4)(A)(ii). The man-made golf course takes up more than 80 percent of the easement. In making the course, Champions used non-native grasses, one of which requires the use of large fans to keep it cool in the hot Georgia sun. And to maintain the course, Champions pumps anywhere from 70,000 to 600,000 gallons of water a day out of the Little River.

Champions also coats its golf course with chemicals — including fungicide, herbicide, insecticide, algaecide, and fertilizer. To apply these potent chemicals, Champions' staff members sometimes need gloves and respirators. The chemicals not only artificially change the habitat, but do so in ways that pose what the tax court called “environmental hazards.” In fact, Champions designed the golf course to drain into nearby ponds, creeks, and otherwise undisturbed wetlands. The golf course drains toward the knotweed (a rare plant that Champions says is protected by the easement), and as the majority itself recognizes, “the knotweed thus may suffer harm from the chemicals used on the course.” Maj. Op. at 14. Although the majority finds comfort in Champions' pledge to follow the golf industry's best environmental practices, we have little information about what those practices are, or how they stack up to other standards. And those standards, whatever they are, hardly define the boundary between easements that can and cannot qualify for a deduction under federal law.

Ultimately, the majority is willing to look past the easement's unnatural features because of the birds and squirrels living there. The argument has some force, especially because it does appear that the tax court overlooked evidence about the prevalence of these species. But the presence of animals cannot hide that a lot of the easement is highly developed and at least somewhat hazardous to certain species. And no matter how many animals live on the Champions easement, the reality remains the same: with the chemicals, imported grasses, large fans, artificial drainage, and water pumping, it is not at all clear that the easement amounts to a “relatively natural habitat.” I do not mean to say that a golf course could never qualify; it's simply not clear that this one does.

## **Perpetuity Requirement in Façade Easement**

. The Sixth Circuit has strictly construed the perpetuity requirement for conservation easements in Hoffman Properties v. Commissioner, 956 F.3d 832 **(**6th Cir. 2020). The opinion states:

The parties agree on the general legal framework. To satisfy the “perpetuity” requirement, the donation must be “[e]nforceable in perpetuity,” meaning that it includes “legally enforceable restrictions” that will prevent the donor from using its retained interest in the property in a way “inconsistent with the [donation’s] conservation purposes.” Treas. Reg. § 1.170A-14(g)(1); *see Glass v. Comm’r*, 471 F.3d 698, 713 (6th Cir. 2006). The parties simply disagree about whether Hoffman’s donation included adequate restrictions.

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The key language in this agreement is in Paragraph 3. That Paragraph describes certain “[c]onditional [r]ights”—actions that Hoffman could take so long as AAHP approved. JA 107. For instance, Hoffman reserved the right to “[a]lter, reconstruct or change the appearance [of the façade] . . . contrary to the Secretary’s Standards” or to “[a]lter or change the appearance of the Air Space in a manner contrary to the Secretary’s Standards.” JA 107–08. (For reference, the “Secretary’s Standards” are regulations issued by the Secretary of the Interior on the rehabilitation of historic buildings. 36 C.F.R. § 67.7.) Paragraph 3 also directs Hoffman to submit these proposed changes to AAHP, which would review the changes based on the Secretary’s Standards and either approve or reject them. Finally, the Paragraph makes clear that AAHP’s “failure . . . to act within forty-five (45) days of receipt [of a proposed change] shall be deemed to constitute approval [of the change] and to permit [Hoffman] to undertake the proposed activity.” JA 108.

Simply put, Paragraph 3 gives AAHP a 45-day window in which to prevent certain changes to the façade or airspace. And if the organization misses that window—for whatever reason—it loses the ability to stop the change. It almost goes without saying that this provision violates the “perpetuity” requirement. After all, there’s a world of difference between restrictions that are enforceable “in perpetuity” and those that are enforceable for only 45 days. *See The American Heritage Dictionary* 977 (1976) (defining “perpetuity” as “[t]ime without end; eternity”); *Black’s Law Dictionary* 711 (5th ed. 1979) (defining “in perpetuity” as “[e]ndless duration; forever”); *Webster’s Third New International Dictionary* 1685 (1986) (defining “perpetuity” as “endless time” and a “duration without limitations as to time”). You can’t even really compare the two.

What’s more, it seems that most (if not all) of the rights reserved in Paragraph 3 could be inconsistent with the conservation purposes of the donation. We know this not only because of the sheer breadth of the reserved rights—for instance, the power to “[a]lter, reconstruct, or change” the façade—but also because many of the rights are expressly defined as “contrary to the Secretary’s Standards.” JA 107. Recall that these standards concern the rehabilitation of historic buildings; they’re designed to ensure that any changes are “consistent with the historic character of the property.” 36 C.F.R. § 67.7(e). And the donation agreement itself tells AAHP to use these standards when it evaluates whether a proposed change would conflict with the purposes of the donation. So it’s not hard to imagine how these changes would be inconsistent with the conservation purposes of the donation. By all appearances, then, the agreement fails to protect these purposes “in perpetuity.”

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*The Donation Agreement*. Hoffman also insists that other provisions in the agreement protect the conservation purposes “in perpetuity.” But this argument misses the point: whatever else the agreement says, Paragraph 3 prevents AAHP from enforcing these provisions if the organization fails to act on the proposed change within 45 days. And again, this brief window falls far short of the statutory requirement that the conservation purposes of the donation be “protected in perpetuity.” I.R.C. § 170(h)(5)(A).

For similar reasons, Paragraph 10 doesn’t do Hoffman any good even though it provides that the agreement “shall be interpreted broadly to effect its purposes and the transfer of rights and the restrictions on use.” JA 118. This provision tells us to construe the agreement, not rewrite it. *Cf. Keen v. Helson*, 930 F.3d 799, 805 (6th Cir. 2019). But there’s no way Hoffman could prevail unless we rewrote some of the terms in Paragraph 3.1.

Footnote 1 addresses savings clauses:

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

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

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

**Constructive Denial.** For activities or uses that are expressly permitted by the terms of the easement only with the easement holder's approval, the property owner's request for approval shall be in writing and shall describe the nature, scope, design, location, timetable, and any other material aspect of the proposed activity or use in sufficient detail to permit the easement holder to make an informed determination regarding approval or denial of the request. Such a request shall be delivered to the easement holder at least sixty (60) days prior to the anticipated start date of such activity or use.

The easement holder agrees to use reasonable diligence to respond to such a request within the sixty (60) days of delivery. The easement holder's failure to respond to such a request within the sixty (60) day period shall be deemed a constructive denial.

Because a constructive denial is not a decision by the easement holder based on the merits of the property owner's request, it is not final or binding on the easement holder, and the property owner can resubmit the same or a similar request for approval.

Section 170(h)(1) allows a deduction for a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes. Section 170(h)(2)(C) states that a qualified real property interest is a restriction (granted in perpetuity) on the use of the real property. Section 170(h)(5)(A) further provides that in order for a contribution to be treated as exclusively for conservation purposes, the conservation purpose must be protected in perpetuity.

CONCLUSION

No, a constructive denial clause is not inconsistent with the perpetuity requirements of section 170(h).

## **No Self-Dealing Where Marital Trust and Charitable Trust Divided Assets**

. A series of complicated transactions “cashing the spouse out” of various trusts were summarized by the IRS in PLR 202016002 as follows:

The transaction pursuant to the Settlement Agreement, in which Spouse will receive the present value of her life income interests in Irrevocable Trust and Marital Trust, and Charitable Trust will receive the remaining trust assets, may be regarded in substance as an indirect exchange between Spouse and Charitable Trust similar to the one described in Rev. Rul. 72-243. Charitable Trust was not funded upon Decedent's death by Decedent, and no deduction has been or will be allowed under § 170, 545(b)(2), 642(c), 2055, 2106(a)(2), or 2522 with respect to Charitable Trust prior to the contemplated exchange. Therefore, prior to the exchange, Charitable Trust is not a trust described in § 4947(a)(1).

As discussed above, Spouse will receive a gift tax deduction under § 2522 of more than $5,000 for the property deemed transferred by her to Charitable Trust (which will exceed 2 percent of all contributions to Charitable Trust), causing Charitable Trust to be subject to § 4947(a)(1) at that time. Spouse will be a disqualified person with respect to Charitable Trust when the Settlement Agreement is executed, as a substantial contributor to Charitable Trust and as a family member of the creator of Charitable Trust. Section 53.4941(d)-1(a) provides, however, that the term “self-dealing” does not include a transaction between a private foundation and a disqualified person where the disqualified person status arises only as a result of such transaction. Accordingly, §4941 will not apply to the indirect exchange between Spouse and Charitable Trust pursuant to the Settlement Agreement in which Spouse will receive the present value of her life income interest in Irrevocable Trust, GST Exempt Marital Trust, and GST Non-Exempt Marital Trust, and Charitable Trust will receive the remaining trust assets.

Based on the facts submitted and the representations made, we conclude that the indirect exchange between Spouse and Charitable Trust pursuant to the Settlement Agreement will not be treated as an act of self-dealing under § 4941.

That the trust was not yet funded was key.

## **Eyewear Contribution Flunks Appraisal Requirements**

. Campbell v. Commissioner, T.C. Memo. 2020-41, deals with a fascinating charitable contribution strategy summarized by the court as follows:

This eyewear charitable contribution program involved ZD Products, Inc. (ZD Products), consolidating over 170,000 designer eyeglass frames it possessed into units of approximately 3,432 frames each and selling these units to 50 buyers for $50,000 per unit; each buyer would then purportedly be eligible to donate his or her frames after a minimum one-year holding period to Lions in Sight, a section 501(c)(3) nonprofit organization[4](https://www.taxnotes.com/tax-notes-today-federal/charitable-giving/tax-court-cant-see-proper-substantiation-eye-wear-donation/2020/04/08/2cd3m?highlight=2020-13415#2cd3m-0000004) (or to a different qualified charitable organization of the buyer's choosing), and claim a charitable contribution deduction at the appraised fair market value at the time of donation.

The appraisal was fascinating:

The initial written appraisal prepared by Marshall & Stevens and dated November 27, 2006 (2006 Marshall & Stevens appraisal), was included with the offering memorandum. The 2006 Marshall & Stevens appraisal described the **[\*6]** property that ZD Products requested it value and the property's physical condition as follows:

**1.3 Description of the Donated Property**

The property to be contributed consists of new (unused) Designer Eyewear Products (“Designer Eyewear Products” or “donated property”). The subject property list with description, count and wholesale price originated from Eyewear Designs LTD. Located in Syosset NY. The subject property consists of various styles and designer brand names. These designer brand names include Bill Blass, Elizabeth Arden, Perry Ellis, and Pierre Cardin. The total quantity is 171,600. A sampling of the various brand names and models show that the eyewear brands are still active in the marketplace. These particular designer eyewear product brand names are some of the most well known and long standing eyewear products in the designer eyewear marketplace. They have however have [sic] been discounted over time and are no longer the most current popular styles and brands.

**1.4 Physical Condition of the Property**

We have not made a personal viewing of the subject property. It is our understanding that the subject property analyzed is in new (unused) condition and that the amount of property or “count” is correct. The current location of the subject property is not known.

The referenced “subject property list” (which was attached to the 2006 Marshall & Stevens appraisal) stated that the “donated property” consisted of 31,950 Bill Blass frames, 23,150 Elizabeth Arden frames, 13,200 Elizabeth Arden “Petites” frames, 33,150 Pierre Cardin frames, 54,350 Perry Ellis frames, and 15,800 Perry Ellis America frames. This list also showed various models within each eyewear brand of varying quantities and wholesale prices. The wholesale price per model **[\*7]** ranged from $37 to $80. Using the market approach[7](https://www.taxnotes.com/tax-notes-today-federal/charitable-giving/tax-court-cant-see-proper-substantiation-eye-wear-donation/2020/04/08/2cd3m?highlight=2020-13415#2cd3m-0000007) and on the basis of the wholesale prices with a markup of 35%, Marshall & Stevens opined that the fair market value of the “donated property” as of November 27, 2006, was $11,266,115.

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Pursuant to the offering memorandum Marshall & Stevens prepared a followup written appraisal for ZD Products; this appraisal was dated December 26, 2007, and certified by Senior Manager Shane Park at Marshall & Stevens (2007 Marshall & Stevens appraisal). The 2007 Marshall & Stevens appraisal contained the same description and physical condition of the “donated property” as the 2006 Marshall & Stevens appraisal except that the total quantity of eyeglass frames had increased to 349,629 (from 171,600) and included the following additional brand names — Laura Ashley, Eddie Bauer, HSM, Nicole Miller, Dakota Smith, and Bebe.

The inventory list attached to the 2007 Marshall & Stevens appraisal stated that the “donated property” consisted of the same quantity and frame models as the inventory list attached to the 2006 Marshall & Stevens appraisal plus 84,847 Laura Ashley frames, 38,923 Eddie Bauer frames, 583 HSM frames, 6,044 Nicole Miller frames, 1,047 Signature Collection frames,[8](https://www.taxnotes.com/tax-notes-today-federal/charitable-giving/tax-court-cant-see-proper-substantiation-eye-wear-donation/2020/04/08/2cd3m?highlight=2020-13415#2cd3m-0000008) 43,411 Dakota Smith frames, and 3,174 Bebe frames. This list also showed various models within each eyewear brand of varying quantities and wholesale prices. Like the inventory list attached to the 2006 Marshall & Stevens appraisal, the wholesale price per model ranged from $37 to $80. Using the market approach and on the basis of the wholesale prices with a markup of 35%, Marshall & Stevens opined that the fair market value of the “donated property” as of December 26, 2007, was $24,019,826.

On April 9, 2008, Marshall & Stevens sent petitioners a letter stating that it had “made an analysis and valuation of the Fair Market Value of Designer Eyewear Products” and that “as a result of our analysis, we have determined that the Fair Market Value of the Designer Eyewear Products you hold is $225,596 based on” the 2007 Marshall & Stevens appraisal. The 2007 Marshall & Stevens appraisal was attached to the letter.

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

Although the 2007 Marshall & Stevens appraisal included Mr. Campbell's 3,432 eyeglass frames, we (and the IRS) have no way to determine whether what he alone contributed is overvalued. This is the type of situation that Congress intended to prevent when it codified more than 15 years ago the requirement that a taxpayer claiming a charitable contribution deduction for the donation of property worth more than $5,000 obtain a qualified appraisal for the property contributed. Sec. 170(f)(11)(C) (as amended by the American Jobs Creation Act of 2004, Pub. L. No. 108-357, sec. 883(a), 118 Stat. at 1631).

Tellingly, the 349,629 eyeglass frames that Marshall & Stevens valued varied in price between $37 and $80, yet petitioners could not discern whether Mr. Campbell's 3,432 frames are from the low end of the price spectrum, the high end, or some varying combination. Indeed, the 2012 Miles appraisal highlights the primary defect of the 2007 Marshall & Stevens appraisal. In the 2012 Miles appraisal, 39,709 of the 349,629 eyeglass frames were assigned a value of zero as of December 2007. Might Mr. Campbell's 3,432 frames been a part of the 39,709 frames?

On brief petitioners argue (via requesting that the Court find as fact) that Mr. Campbell purchased and donated a fractional interest, i.e., an undivided 3,432d interest, in the 349,629 frames. The record unmistakably belies this. As an initial matter, petitioners have stipulated that Mr. Campbell purchased a single allotment of 3,432 eyeglass frames from ZD Products.

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

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

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

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

In Chiarelli v. Commissioner, T.C. Memo. 2021-27, the Tax Court denied charitable contribution of various sizes - > $250 because of no contemporaneous written acknowledgement, > $500 because of no acknowledgement and no form 8283 completed per instructions, and > $5,000, no appraisal. The taxpayer was a lawyer and the court found no reasonable cause.

## **Donation Disallowed Because Appraisal Summary Omitted Basis Information**

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

We have recently held that a taxpayer who fails to disclose “cost or adjusted basis” on its appraisal summary has failed to substantially comply with section 1.170A-13, Income Tax Regs. RERI Holdings I, LLC v. Commissioner, 149 T.C. 1. We decided so because Congress specifically enacted DEFRA's heightened reporting requirements in order to combat inflated charitable deductions by requiring, where reasonably obtainable, the disclosure of “cost or adjusted basis” to “facilitate the Commissioner's efficient identification of overvalued property.” Belair Woods, LLC v. Commissioner, at \*17. Thus, a taxpayer's failure to provide the “cost or adjusted basis” on an appraisal summary is a failure to substantially comply with DEFRA sec. 155 because it is a failure to “provide[ ] sufficient information to permit \* \* \* [the Commissioner] to evaluate the[ ] reported contributions, as intended by Congress.” Smith v. Commissioner, 2007 WL 4410771, at \*20; see also Belair Woods, LLC v. Commissioner, at \*15-\*20.

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

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

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

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

The charity itself was interesting:

Petitioners resided in Maryland when they filed their petition. On or about July 1, 2013, petitioners purchased real property in Potomac, Maryland. The property was purchased for $795,000 and consisted of 0.38 acres of land and a single-family house. Petitioners desired to demolish the house and construct in its place a new residence of their own design.

Second Chance, Inc. (Second Chance), is incorporated under the laws of Maryland and qualifies as a charitable organization under section 501(c)(3). Second Chance performs deconstruction, which is something less than demolition. Where demolition typically results in annihilation of a structure, deconstruction might involve only the removal of furniture, appliances, fixtures, lumber, and other materials. Second Chance sells salvageable material from deconstruction on the open market through its warehouse. But Second Chance's raison d'être is to use the deconstruction process to teach marketable skills to persons facing barriers to employment ranging from limited education to criminal records while environmentally reusing materials that would otherwise end up as landfill debris.

Typically, at the stage where the decision has been made to demolish a structure, the owner will enter into an agreement with Second Chance to allow Second Chance to use the structure for deconstruction. The owner will also make a cash contribution to Second Chance, which covers the upfront costs of Second Chance's deconstruction. Once Second Chance has finished its training and removed salvageable materials, the owner will engage a third party to demolish the structure.

Second Chance contacted petitioners via email on May 3, 2013, explaining its deconstruction program. The email noted that a contribution would generate a tax deduction and included a “Tax Strategy Planning Worksheet”. It further noted that a demolition company would still have to be engaged and that the demolition company's cost would be constant in the project.

Footnote 2 states:

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

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

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

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

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

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

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

## **Judicial Ethics, Oklahoma**

. A judge may not serve as a trustee of a charitable foundation under Oklahoma law. Oklahoma Judicial Ethics Opinion 2020-1, 2020 WL 7863327. A friend died and created a charitable foundation; the judge was to be one of three trustees. A duty of the trustees was to select charitable distributees. The Ethics Commission reasoned that “[t]he trustees of the newly created charitable foundation could put themselves in conflicting situations with other charities based on their decisions of granting or denying the other charities' requests for funding.” Rule 3.7 of the Code of Judicial Conduct provides:

**RULE 3.7 Participation in Educational, Religious, Charitable, Fraternal, or Civic Organizations and Activities**

(A) Subject to the requirements of Rule 3.1, a judge may participate in activities sponsored by organizations or governmental entities concerned with the law, the legal system, or the administration of justice, and those sponsored by or on behalf of educational, religious, charitable, fraternal, or civic organizations not conducted for profit, including but not limited to the following activities:

(1) assisting such an organization or entity in planning related to fund-raising, and participating in the management and investment of the organization's or entity's funds;

(2) soliciting contributions for such an organization or entity, but only from members of the judge's family, members of the judge's household or from judges over whom the judge does not exercise supervisory or appellate authority;

(3) soliciting membership for such an organization or entity, even though the membership dues or fees generated may be used to support the objectives of the organization or entity, but only if the organization or entity is concerned with the law, the legal system, or the administration of justice;

(4) appearing or speaking at, receiving an award or other recognition at, being featured on the program of, and permitting his or her title to be used in connection with an event of such an organization or entity, but if the event serves a fund-raising purpose, the judge may participate only if the event concerns the law, the legal system, or the administration of justice;

(5) making recommendations to such a public or private fund-granting organization or entity in connection with its programs and activities, but only if the organization or entity is concerned with the law, the legal system, or the administration of justice; and

(6) serving as an officer, director, trustee, or nonlegal advisor of such an organization or entity, unless it is likely that the organization or entity:

(a) will be engaged in proceedings that would ordinarily come before the judge; or

(b) will frequently be engaged in adversary proceedings in the court of which the judge is a member, or in any court subject to the appellate jurisdiction of the court of which the judge is a member.

COMMENT

[1] The activities permitted by paragraph (A) generally include those sponsored by or undertaken on behalf of public or private not-for-profit educational institutions, and other not-for-profit organizations, including law-related, charitable, and other organizations.

[2] Even for law-related organizations, a judge should consider whether the membership and purposes of the organization, or the nature of the judge's participation in or association with the organization, would conflict with the judge's obligation to refrain from activities that reflect adversely upon a judge's independence, integrity, and impartiality.

[3] Mere attendance at an event, whether or not the event serves a fund-raising purpose, does not constitute a violation of paragraph 4(A). It is also generally permissible for a judge to serve as an usher or a food server or preparer, or to perform similar functions, at fund-raising events sponsored by educational, religious, charitable, fraternal, or civic organizations. Such activities are not solicitation and do not present an element of coercion or abuse the prestige of judicial office.

[4] Identification of a judge's position in educational, religious, charitable, fraternal, or civic organizations on letterhead used for fund-raising or membership solicitation does not violate this Rule. The letterhead may list the judge's title or judicial office if comparable designations are used for other persons.

Presumably the concern was that the judiciary could be seen as favoring or disfavoring certain charities.

## **No Self-Dealing Due To Tax Reimbursement Provision After Spouses’ Deaths**

. In PLR 202042007 husband had created Trust A, wife had created Trust B, each a revocable trust that had become irrevocable when each died. Husband’s estate is subject to estate tax because Trust B became a QTIP for husband at wife’s death and Trust B contains a tax reimbursement provision in favor of husband’s estate. The reimbursement would be in the form of closely-held stock and husband’s estate would seek to pay the estate tax using section 6166. Meanwhile, the assets in Trust A would pay to the couple’s private foundation, generating no estate tax.

The issue was that at husband’s death half of the QTIP, Trust B, passed to the foundation, so would the payment of estate tax be indirect self-dealing? The IRS concluded it would not:

H's estate will pay an estate tax that results from the inclusion of the assets of Trust B in H's estate for tax purposes. Trust B, pursuant to the Trust B trust agreement and the order of the probate court, is reimbursing H's estate, in kind, with Corporation stock having a fair market value equal to the estate tax resulting from the inclusion of the Trust B assets in H's estate.

Trust B requires the trustee of Trust B to reimburse H's estate for the estate taxes resulting from the inclusion of the assets of Trust B in H's estate before making any distributions to beneficiaries. Thus, the reimbursement by Trust B to H's estate in the form of Corporation shares pursuant to Trust B trust agreement is payment of a necessary expense associated with the administration of Trust B. Taxpayer's only interest in Trust B is as a residuary beneficiary. Thus, while under *Reis*, supra, Taxpayer has an interest in the Trust B residuary assets, Taxpayer has no interest in the stock transferred to H's estate to satisfy Trust B's reimbursement obligation because, by definition, it is not part of the Trust B residuary.

The reference to Reis is to Estate of Reis v. Commissioner, 87 T.C. 1016 (1986) in which the Tax Court held that where an estate passed to a foundation the assets of the estate are akin to assets of the foundation and actions affecting them are subject to the self-dealing rules.

## **Pre-Arranged Sales**

. Under the anticipatory assignment of income doctrine, a taxpayer who earns or otherwise creates a right to receive income will be taxed on any gain realized from that right if, based on the realities and substance of events, the receipt of income is practically certain to occur, even if the taxpayer transfers the right before receiving the income (see Ferguson v. Commissioner, 174 F.3d 997 (9th Cir. 1999); Lucas v. Earl, 281 U.S. 111 (1930)). The related step transaction doctrine similarly prevents a taxpayer from escaping taxation by collapsing a series of substantially linked steps into a single overall transaction (see Penrod v. Commissioner, 88 T.C. 1415, 1428 (1987)).

In Palmer v. Commissioner (62 T.C. 684 (1974), aff'd on other grounds, 523 F.2d 1308 (8th Cir. 1975), acq, 1978-1 C.B. 2), the Tax Court held that a taxpayer's gift of stock in a closely-held corporation to a private foundation, followed by a redemption, would not be characterized as a sale or redemption between the taxpayer and the corporation followed by a gift of the redemption proceeds to the foundation, because the foundation was not legally obligated to redeem the stock at the time it received the shares. In Revenue Ruling 78-197 (1978-1 C.B. 83), the Service announced that it would treat the proceeds of a stock redemption under facts similar to those in the Palmer case as income to the donor only if the donee is legally bound or can be compelled by the corporation to surrender the shares for redemption. The “bright line” test of Palmer and Revenue Ruling 78-197 is not haze free.

In Blake v. Commissioner, 42 T.C.M. 1336 (1981), aff’d, 697 F.2d 473 (2d. Cir. 1982), the donor contributed stock to a charity with the understanding that the charity would permit the corporation to redeem the stock and the charity would then use the proceeds to buy the donor’s yacht at an inflated price. The yacht was sold shortly thereafter by the charity for less than 50 percent of the price it had paid the donor. The Second Circuit Court of Appeals found the “understanding” enough to re-characterize the transaction as a sale of stock by the donor, followed by a contribution of the yacht to charity. Note that, unlike in other situations, there was a quid pro quo required by the donor in order for the donor to make the stock gift.

In Ferguson v. Commissioner, 108 T.C. 244, (1997), aff’d, 174 F.3d 997 (9th Cir. 1999), there was a gift of stock followed by a redemption pursuant to the terms of a merger agreement. The donors were directors and minority shareholders of Company A. On day 1, Company A entered into an agreement and plan of merger with Company B. Company A’s board of directors (the donors abstaining) approved the merger and recommended it to the shareholders. On day 6, Company B made its tender offer. By day 34, more than 50 percent of the shareholders had tendered their shares. On day 43, the donors donated some of their Company A stock to a charity, which in turn immediately tendered the stock to Company B. On day 46, Company B announced its acceptance of all the tendered shares and purchased all of the shares on day 47. The Tax Court found that the donors were taxable on the gain from the stock transferred to charity because by the date of the gift the donors’ interest had been converted from an interest in a viable corporation to a fixed right to receive cash. The Ninth Circuit Court of Appeals affirmed, holding that the transaction had “ripened” into a right to receive sale proceeds once 50 percent shareholder approval for the merger had been reached.

The application of Revenue Ruling 78-197 again arose in Gerald A. Rauenhorst, et al. v. Commissioner, 119 T.C. No. 9 (2002). In that case, Arbeit (a partnership) owned warrants enabling it to purchase NMG stock. On September 28, 1993, WCP (a corporation) offered to purchase all NMG stock. On November 9, 1993 the partnership assigned some warrants to four charities. On November 19 Arbeit sold its remaining warrant to WCP, and the charities sold their warrants to WCP. On November 22, 1993, WCP and NMG agreed on a sale of all the NMG stock. The government argued that the bright-line test of Revenue Ruling 78-197 was not controlling. The court held that, based on the facts of the case and the “no legal obligation” test of Palmer and Revenue Ruling 78-197, there was no prearranged sale, and in the process took a very dim view of the government’s urging to ignore the ruling:

While this Court may not be bound by the Commissioner’s revenue rulings, and in the appropriate case we could disregard a ruling or rulings as inconsistent with our interpretation of the law, see Stark v. Commissioner, 86 T.C. 243, 251 (1986), in this case it is respondent who argues against the principles stated in his ruling and in favor of our previous pronouncements on this issue. The Commissioner’s revenue ruling has been in existence for nearly 25 years, and it has not been revoked or modified. No doubt taxpayers have referred to that ruling in planning their charitable contributions, and, indeed, petitioners submit that they relied upon that ruling in planning the charitable contributions at issue. Under the circumstances of this case, we treat the Commissioner’s position in Rev. Rul. 78‑197, 1978‑1 C.B. 83, as a concession. Accordingly, our decision is limited to the question whether the charitable donees were legally obligated or could be compelled to sell the stock warrants at the time of the assignments.

A footnote to the opinion states as follows:

The record indicates that no agreement was entered into by the donees before Nov. 19, 1993, the date they signed the warrant purchase and sale agreement. On Nov. 16, 1993, NMG’s legal counsel sent letters to each of the donees enclosing a warrant purchase and sale agreement. Those letters state that pursuant to the warrant purchase and sale agreement, the donees would agree to sell their reissued warrants to WCP and “to abstain from either exercising its Warrant or selling or otherwise transferring it to any other party through Dec. 31, 1993.” Certainly, the formality of having the donees enter into the warrant purchase and sale agreements suggests that they had not entered into any binding agreements before Nov. 19, 1993.

Subsequent to Rauenhorst, the government reiterated its intention, generally, to follow its own rulings in litigation. In PLR 200230004, a husband and wife proposed to transfer 495 of 500 shares of a C corporation to a charitable remainder unitrust and asked whether the redemption would be treated as an assignment of income. The ruling first describes Palmer and Revenue Ruling 78-197 and then states as follows:

In the present case, at the time X shares are transferred to Trust, X will be under no legal obligation to redeem the contributed stock. There is no agreement among the parties under which X would be obligated to redeem, or Trust would be obligated to surrender for redemption, the stock. Trust is not legally obligated to accept any offer of redemption made by X. Accordingly, any redemption by X of the stock contributed by Grantors to Trust will be respected.

Based on the representations submitted and information described above, we conclude that a purchase by X of the stock transferred by Grantors to Trust will be treated as a redemption of the stock from Trust, and will not be treated as a redemption of stock from Grantors or a distribution by X to Grantors. Therefore, the sale or redemption by Trust of its X stock will not result in the capital gain in such sale or the redemption price being attributed for tax purposes to Grantors.

In PLR 200321010, a retired officer of a corporation intended to give shares of the corporation to a charitable remainder unitrust. The transfer would trigger an option under a shareholder agreement, giving the company the right to purchase the stock for a formula price. The ruling described the “bright-line” test of Palmer, cited Rauenhorst, and concluded as follows:

Consequently, the test for purposes of this ruling request, is whether the CRUT will be legally bound or can be compelled by Company to surrender the stock for redemption at the time of the donation. Here, X proposes to transfer the Company stock to the CRUT. Under the restrictions contained in each year’s stock restriction agreement, the CRUT must first offer the stock to Company at a set formula price should the CRUT propose to dispose of the shares. This provision amounts to a right of first refusal. However, it does not mean that the CRUT is legally bound or can be compelled by Company to surrender the stock to Company at the time of the donation. The information submitted contains no indication that the CRUT will be legally bound, or could be compelled by Company, to redeem or sell the gifted stock. That all or a portion of the gifted stock was subject to restrictions upon transfer to a third party by X, and thus by the CRUT following the transfer, does not give Company the ability to compel its redemption or sale from the CRUT. The CRUT is free to retain title to and ownership of the stock indefinitely.

Because the CRUT is not legally bound and cannot be compelled by Company to redeem or sell the stock, we conclude that the transfer of the Company stock by X to the CRUT, followed by any subsequent redemption of the stock by Company, will not be recharacterized for federal income tax purposes as a redemption of the stock by Company from X followed by a contribution of the redemption proceeds to the CRUT. See Palmer v. Commissioner, supra, and Rev. Rul. 78‑197, supra. The same principles apply if the stock is sold by the CRUT rather than redeemed by Company. Thus, provided there is no prearranged sale contract whereby the CRUT is legally bound to sell the stock upon the contribution, we conclude that any subsequent sale will not be recharacterized for federal income tax purposes as a sale of the stock by X, followed by a contribution of the sale proceeds to the CRUT. Accordingly, any redemption proceeds or sales proceeds received by the CRUT for the stock will not be treated as taxable income received by X.

See also PLR 200821024 to the same effect.

In Dickinson v. Commissioner, T.C. Memo. 2020-128, Judge Greaves reached the right result but the litigation itself is disturbing. The CFO of a private company donated shares to a donor advised fund (DAF) when allowed to transfer shares by the board, on three occasions. The board was comfortable allowing the transfers because the DAF had a policy of trying to sell closely-held shares quickly which meant, as a practical matter, offering the shares back to the company. In fact, after each donation the company redeemed the shares.

The IRS treated the donation and redemption as an integrated whole to claim the taxpayers in effect sold the stock and contributed the proceeds. Why is puzzling. One would have thought that Rev. Rul. 78-197 would have been dispositive for the taxpayers but apparently not. The opinion discusses that ruling as follows:

The parties point us to Rev. Rul. 78-197, 1978-1 C.B. 83, a “bright-line” rule the IRS applies in cases like Palmer, which focuses on the donee’s control over the disposition of the appreciated property. See Rauenhorst v. Commissioner, 119 T.C. at 165. This Court has not adopted Rev. Rul. 78-197, supra, as the test for resolving anticipatory assignment of income issues, see Rauenhorst v. Commissioner, 119 T.C. at 166, and does not do so today. The ultimate question, as noted in Palmer, is whether the redemption and the shareholder’s corresponding right to income had already crystallized at the time of the gift. See Palmer v. Commissioner, 62 T.C. at 694-695. Regardless of whether the donee’s obligation to redeem the stock may suggest the donor had a fixed right to redemption income at the time of donation, See Rauenhorst v. Commissioner, 119 T.C. at 166-167, respondent does not allege that petitioner husband had any such right in this case. Accordingly, respondent’s resort to Rev. Rul. 78-197, supra, is unavailing.

The opinion relies on a two-prong approach set forth in Humacid Co. v. Commissioner, 42 T.C. 894 (1964), which respected the form of the transaction if the taxpayer (1) gives the property away absolutely and parts with title thereto (2) before the property gives rise to income by way of a sale.

The court determined both prongs were easily met. Even a “preexisting understanding among the parties that the donee would redeem donated stock does not convert a postdonation redemption into a predonation redemption.”

The opinion notes:

Furthermore, neither a pattern of stock donations followed by donee redemptions, a stock donation closely followed by a donee redemption, nor selection of a donee on the basis of the donee's internal policy of redeeming donated stock suggests that the donor failed to transfer all his rights in the donated stock. See, e.g., [Grove v. Commissioner, 490 F.2d at 242–245](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1973112800&pubNum=0000350&originatingDoc=Ief904350ee4311eaac1bf54738486b58&refType=RP&fi=co_pp_sp_350_242&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_350_242) (respecting form of transaction where donee needed to fundraise to support its operations, and over a decade consistently redeemed annual donations of stock for which donor remained entitled to dividends); [Carrington v. Commissioner, 476 F.2d at 705–706](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1973109438&pubNum=0000350&originatingDoc=Ief904350ee4311eaac1bf54738486b58&refType=RP&fi=co_pp_sp_350_705&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_350_705) (respecting form of transaction where donee redeemed stock eight days after it was donated); [Palmer v. Commissioner, 62 T.C. 684, 692–693 (1974)](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1974290224&pubNum=0000838&originatingDoc=Ief904350ee4311eaac1bf54738486b58&refType=RP&fi=co_pp_sp_838_692&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_838_692), (respecting form of transaction where, pursuant to a single plan, the taxpayer donated stock to a foundation and then caused the corporation to redeem the stock from the foundation the day after the donation), aff'd, [523 F.2d 1308 (8th Cir. 1975)](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1975142343&pubNum=0000350&originatingDoc=Ief904350ee4311eaac1bf54738486b58&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)). Petitioners' contemporaneous documentary evidence of an absolute gift, and respondent's failure to assert facts indicating any genuine controversy on this point, lead us to conclude that petitioner husband's donations satisfy the first Humacid requirement.

With respect to second prong, the court follows a “practically certain” analysis which is squishier that the bright-line test of Rev. Rul. 78-197:

Where a donee redeems shares shortly after a donation, the assignment of income doctrine applies only if the redemption was practically certain to occur at the time of the gift, and would have occurred whether the shareholder made the gift or not. See Palmer v. Commissioner, 62 T.C. at 694–695; see also Ferguson v. Commissioner, 174 F.3d 997, 1003–1004 (9th Cir. 1999) (finding that the shareholder recognizes income from a stock sale where acquisition is “practically certain to occur”, rather than the subject of “a mere anticipation or expectation”, before the shareholder donates stock), aff'g [108 T.C. 244 (1997)](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1997098501&pubNum=0000838&originatingDoc=Ief904350ee4311eaac1bf54738486b58&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)). In [Hudspeth v. United States, 471 F.2d 275, 276 (8th Cir. 1972)](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1972113351&pubNum=0000350&originatingDoc=Ief904350ee4311eaac1bf54738486b58&refType=RP&fi=co_pp_sp_350_276&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_350_276), for example, the court recast a stock donation as a taxable stock sale and donation of the sale proceeds where the taxpayer donated stock after the issuing corporation's directors and shareholders had adopted a plan of complete liquidation. See also Jones v. United States, 531 F.2d 1343, 1343–1344 (6th Cir. 1976); Allen v. Commissioner, 66 T.C. 340, 347 (1976).[2](https://1.next.westlaw.com/Document/Ief904350ee4311eaac1bf54738486b58/View/FullText.html?transitionType=UniqueDocItem&contextData=(sc.UserEnteredCitation)&userEnteredCitation=T.C.+Memo.+2020-128#co_footnote_B00022051785606) By contrast, there was no assignment of income in Palmer v. Commissioner, 62 T.C. at 687–688, 695, even though all parties were related and anticipated the redemption before the donation, because “no vote for the redemption had yet been taken” when the shareholder donated the stock. As in Palmer, the redemption in this case was not a fait accompli at the time of the gift.

## **Another Favorable Note to CLT Via Non-Voting LLC Interests Ruling**

. Many individuals sell assets during lifetime to family trusts in exchange for notes. A foundation or entity like a CLT that is similarly subject to the self-dealing rules of section 4941 may not hold those notes, because the obligor trust will be a disqualified person with respect to the CLT. The solution to this problem is to drop the note into an LLC and transfer non-voting interests to the CLT. Such was allowed most recently in PLR 202037009 which states:

CLT proposes that Revocable Trust form LLC and contribute cash and the Note to LLC in exchange for 100% of LLC’s ownership interests, 99% of which are nonvoting interests and 1% of which are voting interests. Revocable Trust will satisfy its distribution obligations by distributing to CLT an amount of nonvoting interests in LLC with a value equal to CLT’s full distribution entitlement. The remaining undistributed nonvoting interests and all voting interests in LLC will be distributed to the other Revocable Trust beneficiaries, A, B, and C in their individual capacities, and not as trustees of CLT.

Pursuant to the LLC operating agreement, LLC will be managed by a single manager (Manager) who is selected and may be removed by a vote of the members holding a majority of the voting interests. The holders of the nonvoting interests will possess no management rights or rights to vote on the appointment or removal of Manager. An amendment to the LLC operating agreement or dissolution of the LLC requires the approval of all members, whether holding voting or nonvoting interests.

LLC will hold and administer the Note and receive payments of interest and principal on the Note. Aside from the cash initially contributed to LLC by Revocable Trust, LLC’s PLR-133620-18 3 sole asset and source of income will be the Note. CLT will engage only in passive investment activities, and not in the operation of any business enterprise. At least 95% of CLT’s gross income will be from passive investments including interest and dividends.

\* \* \*

CLT will not “control” LLC within the meaning of Treas. Reg. § 53.4941(d)-1(b)(5) due to a lack of voting power. As holder of the nonvoting interests, CLT will have no management rights or right to vote on the manager of LLC. The other beneficiaries of Revocable Trust will own all of the voting interests, giving them the right to select and remove the manager LLC. As a holder of nonvoting interests, CLT will have a right to receive distributions only if LLC dissolves or chooses to make current distributions, but the timing and amount of such distributions will be uncertain and cannot be compelled by CLT. Only the other beneficiaries of Revocable Trust, as the holders of the voting interests, may elect or remove the Manager, who will have the sole power to manage the affairs of LLC and determine the timing and amount of distributions. Thus, CLT and CLT’s trustees (acting only in such capacity) will not have sufficient votes or positions of authority to cause LLC to engage in a transaction.

Additionally, CLT will not have the power to compel dissolution of LLC since LLC may only be dissolved with written approval of all members, including the holders of the voting interests. The power associated with the nonvoting interests of LLC as a necessary party to vote on the liquidation of LLC is not considered equivalent to a “veto power” within the meaning of Treas. Reg. § 53.4941(d)-1(b)(5) because the power cannot be exercised over an action relevant to any potential act of self-dealing. Consequently, CLT will not “control” LLC within the meaning of Treas. Reg. § 53.4941(d)-1(b)(5)

Accordingly, CLT’s receipt of nonvoting interests in LLC from Revocable Trust will not constitute a loan or extension of credit between a “private foundation” and a “disqualified person” within the meaning of section 4941(d)(1)(B) and Treas. Reg. §53.4941(d)-2(c) because CLT will not acquire an interest in the promissory note; instead, CLT will acquire nonvoting interests in LLC, with respect to which it will not have any management rights or control over distributions.

Thus, CLT’s receipt and continued ownership of nonvoting interests in LLC will not constitute an act of self-dealing described in section 4941.

\* \* \*

Under Treas. Reg. § 53.4941(d)-1(b)(4), a transaction between a private foundation and an organization does not result in an act of self-dealing where the organization is neither controlled by the foundation nor does it have a disqualified person owning at least a 35% beneficial interest in the organization. Here, as explained above, CLT does not control LLC because CLT only holds nonvoting interests, with the only voting interests in LLC held by the other Revocable Trust beneficiaries. Although the other Revocable Trust beneficiaries may be trustees of CLT and thus disqualified persons, they own the voting interests in LLC in their individual capacities and not as foundation managers of CLT. Further, the other Revocable Trust beneficiaries only own an approximately 1% beneficial interest in LLC, below the 35% threshold.

\* \* \*

LLC’s sole asset will be the Note, which will generate passive income in the form of interest, as described in sections 4943(d)(3) and 512(b)(1). As such, LLC will not be considered a “business enterprise” for purposes of section 4943(d)(3) because at least 95 percent of its gross income will derive from passive sources. See also Treas. Reg. § 53.4943-10(c)(1). Because LLC will not be considered a “business enterprise,” the restrictions on excess business holdings under section 4943 will not apply. Thus, CLT’s receipt and continued ownership of nonvoting interests in LLC will not result in excess business holdings under section 4943.

See also PLR 202101002, involving the sale during lifetime to a joint revocable trust followed by approval of the note contribution via an LLC. Practitioners have heard that the IRS may change this ruling position.

## **Termination of a CRAT**

. In PLR 202047005 spouses were annuity beneficiaries of a charitable remainder annuity trust. The spouses assigned their annuity interests to the remainder charity which became the only beneficiary of the trust. The trust would then be dissolved by court order. The annuitant spouses were also trustees of the CRAT. The IRS determined there would be no self-dealing nor income tax at termination. The spouses would receive no income tax deduction for the contribution because they have no basis in the annuity interest. The ruling notes:

In Rev. Rul. 86-60, 1986-1 C.B. 302, Situation 1, in 1980, A created a charitable remainder annuity trust described in section 664(d)(1). A retained the annuity interest in the trust for life. The remainder beneficiary was X, a charitable organization described in sections 170(c) and 2522(a). In 1984, A transferred the entire annuity interest in the trust to X. The Service ruled that, although A had previously divided the interest A held in the property, the division was not to avoid section 170(f)(2)(A). Thus, under section 1.170A-7(a)(2)(i), A’s transfer of A’s entire life annuity interest qualified for an income tax charitable deduction.

\* \* \*

Generally, section 170(a)(1) would permit an income tax charitable contribution deduction for the present value of an annuity interest assigned to a charitable organization; such assignment would be treated as a gift for Federal income tax purposes.

Analogous to the taxpayer in Situation 1 in Rev. Rul. 86-60, Taxpayer and Spouse desire to transfer their undivided annuity interest to Foundation, a charitable organization described in sections 170(c) and 2522(a). Pursuant to section 170(e)(1)(B)(ii), Taxpayer’s and Spouse’s income tax charitable contribution deduction will be reduced by the total amount of the gain that would have been realized if the contributed property had been sold at its fair market value. Pursuant to section 1001 et. seq., as described above, Taxpayer’s and Spouse’s basis in the annuity interest will be zero, thus resulting in a gain equal to their entire interest transferred, and no income tax charitable contribution deduction will be allowed for the assignment of their annuity interest.

Despite the fact that Taxpayer and Spouse will not be eligible for an income tax charitable contribution deduction for the assignment of their undivided annuity interest, Rev. Rul. 86-60 provides that the assignment of an annuity interest is treated as a gift under section 1.170A-1(h), and not as a sale or exchange of a capital asset that would result in taxable income to Taxpayer and Spouse.

Section 170(a)(1) allows as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year. Special rules apply for contributions to private foundations. Pursuant to section 170(e)(B)(ii), the amount of any charitable contribution of property otherwise taken into account under section 170 is reduced by the sum of, in the case of a charitable contribution to or for the use of a private foundation (as defined in section 509(a)), other than a private foundation described in subsection (b)(1)(F), the amount of gain which would have been long-term capital gain if the property contributed had been sold by the taxpayer at its fair market value (determined at the time of such contribution). As a result, the charitable contribution deduction for appreciated property to private foundations is generally limited to the donor’s basis in the property, which in this case, is zero.

## **Disqualified Person for Section 4958 Purposes**

. The case of Fumo v. Commissioner, T.C. Memo. 2021-61, is a good reminder that section 4958 applies to individuals who can exercise “substantial influence” over a charity making them a disqualified person subject to excise taxes even if not officially an officer, director, or employee. The opinion summarizes the situation as follows:

Petitioner was convicted in 2009 on Federal criminal charges, including mail and wire fraud. One victim of his fraud was Citizens Alliance for Better Neighborhoods (Citizens Alliance), an organization exempt **[\*2]** from Federal income tax under section 501(a) and (c)(3).[1](https://1.next.westlaw.com/Document/Id8bca960b7f711eb9804b7f7250bc080/View/FullText.html?transitionType=UniqueDocItem&contextData=(sc.Search)&userEnteredCitation=t+c+memo+2021-61#co_footnote_B00012053651086) In May 2013 the Internal Revenue Service (IRS or respondent) determined that petitioner was liable for excise taxes under section 4958(a)(1). That section imposes, in the case of any “excess benefit transaction” involving a charity, a tax equal to 25% of the excess benefit, and provides that such tax “shall be paid by any disqualified person \* \* \* with respect to such transaction.”

A “disqualified person” is defined to include anyone who was, during a five-year look-back period, “in a position to exercise substantial influence over the affairs of the organization.” Sec. 4958(f)(1)(A). Respondent has filed a motion for partial summary judgment contending that petitioner was a “disqualified person” with respect to Citizens Alliance during 2002-2004. Although he was not an officer, director, or employee of the organization, we agree with respondent that he was “in a position to exercise substantial influence over \* \* \* [its] affairs.” Ibid.

The larger background is more colorful:

Petitioner himself was never employed as an officer, director, trustee, or employee of Citizens Alliance. However, he used his power and influence as the chairman of a senate appropriations committee to obtain funding for the organization from a variety of public and private sources. During 1991-2004 he was instrumental in securing at least $15 million in public grants for Citizens Alliance and a comparable volume of funding from private sources. This included a $17 million grant from a public utility, which Citizens Alliance received after petitioner agreed to drop a lawsuit against the utility.

In February 2007 a grand jury charged petitioner with 139 counts of criminal activity. Thirty-four of these counts, on which Ms. Arnao was charged as a codefendant, related to a scheme to defraud Citizens Alliance. The indictment alleged that petitioner and Ms. Arnao conspired to use Citizens Alliance's funds to purchase vehicles, farm equipment, tools, and consumer goods for petitioner's use and make other expenditures on his behalf (e.g., for foreign travel, the services of a private investigator, and cell phone service for his chauffeurs and daughter).

In March 2009, following a six-month trial, petitioner was convicted on all 34 counts related to the scheme to defraud Citizens Alliance. After several appeals related to sentencing, petitioner was ultimately required to pay Citizens Alliance restitution of $1,165,317. That was the amount of loss petitioner caused to the organization, as determined by the trial court.

Petitioner testified during his criminal trial. He testified that he considered Citizens Alliance a “constituent service” of his senate office and expected to derive political benefits from the work it performed in his district. Although Ms. Arnao exercised day-to-day control over the organization's affairs, petitioner approved most significant projects and directed many major expenditures (including purchase of the office building that housed his first district office).

Petitioner testified that he received over the years many “perks and gifts” from Citizens Alliance. He owned several residences, including a farm near Harrisburg, and he was apparently something of a tool aficionado. He admitted at trial that, between 1998 and 2003, he received $43,000 in tools paid for by Citizens Alliance. When he wanted the organization to purchase tools for him, he testified that he would email Ms. Arnao or another senate staff member, who would order the tools using Citizens Alliance's credit card.

Petitioner routinely enjoyed the use of trucks, minivans, and other vehicles owned or leased by Citizens Alliance. He admitted at trial that, in 2003, the organization paid for a bulldozer that was used exclusively on his farm. When the bulldozer broke down in December of that year, Citizens Alliance paid $16,000 to repair it.

Petitioner admitted at trial that he “did have a significant role” in Citizens Alliance. While he “did not make all the decisions,” he “did make a lot of decisions on important topics.” As he explained: “I don't have a title or a job. Do I have influence? Yes.” When asked by his defense attorney to describe his relationship with Citizens Alliance, he stated: “I viewed it as my non-profit. I viewed it as my entity, my baby. Gave it birth and nursed it along, got involved more with strategy and ideas. You know, that's how we viewed it. And we ran it out of our office.” On cross-examination he testified similarly: “I created it. I helped it. I guided it. I gave it strategy. I gave it my time and effort. I raised money for it. If it weren't for me, it wouldn't exist.”

## **Donor Challenge to Charity’s Promise**

. Malcolm and Emily Fairbairn gave a significant amount of Energous stock to charity in December, 2017. They believed the charity had promised to liquidate the stock in a particular way, did not, and reduced the benefit to their fund and the amount of their income tax deduction. Before the court in Fairbairn v. Fidelity Investments Charitable Gift Fund, 2021 WL 754534 (N.D.Ca. 2021) was whether the donors could recover damages. The court held no. More specifically, the donors made these claims:

The Fairbains [*sic*] allege that Fidelity Charitable representative Justin Kunz made four separate promises on December 27 or December 28, 2017 to entice them to donate 1.93 million-WATT shares to their Fidelity Charitable DAF:

• Fidelity Charitable would not trade more than 10% of the daily trading volume of Energous shares,

• Fidelity Charitable would employ sophisticated, state-of-the art methods for liquidating large blocks of stock,

• Fidelity Charitable would allow the Fairbairns to advise on a price limit (i.e., a point below which Fidelity would not sell shares without first consulting the Fairbairns), and

• Fidelity would not liquidate any of the donated Energous shares until the new year.

(Dkt. No. 1 at ¶ 65.) The Fairbairns contend that Fidelity Charitable did not do as Kunz promised and therefore Fidelity Charitable is liable for common law misrepresentation, breach of contract, promissory estoppel and violating California's unfair competition law.

The court held that Fidelity never sold more than 10% in a day. The other promises the court found Fidelity simply did not make:

The Fairbairns’ conduct after they learned that the shares had all been sold on December 29 also weighs against a finding that the promises were made. When Malcolm learned on January 5, 2018 about the December 29 sale of the WATT shares, he did not confront Kunz by email or telephone about the alleged broken promises. Indeed, it was not until January 15, 2018 that the Fairbairns even mentioned to Fidelity Charitable that the liquidation had violated promises made to them. Malcolm's testimony that he was too angry and needed to cool off would make sense for a few hours, or maybe a few days, but 10 days of silence is hard to understand.

Further, in January 2018, when the Fairbairns were communicating with Kunz about the liquidation, they never asserted that Kunz had made those promises. Instead, in their communications with Kunz they stated they “were told,” or “the DAF people” had told them, without suggesting that Kunz was the DAF person who told them. Emily's testimony that she said “the DAF people” rather than “You” because she did not want to accuse Kunz of wrongdoing while he was trying to rectify the situation within Fidelity Charitable is not persuasive. In the very same communications Emily also tells Kunz: “I do want you to know how much I respect your *integrity* and efforts.” (Ex. 174 (emphasis added).) It is one thing to not directly accuse the person who lied to you; it is another to gratuitously tell that person you respect their integrity.

As to the alleged promise to allow the Fairbairns to advise on a sale price limit, even the email Malcolm wrote on January 15, 2018 in which he states for the first time that he was told certain things, represents only that he was told (by some unidentified person) that the Fairbairns could advise on a price limit “if necessary.” (Ex. 128.) The email is consistent with Malcolm's trial testimony: “if we run into a problem, or if there is something that's coming up, and if we're having any sort of difficulty in selling the stock, that, you know, I would be called, advised, I would be able to advise.” (Dkt. No. 242 at 371.) Even accepting Malcolm's testimony, the ability to advise on a price was only if Fidelity Charitable was having difficulty in selling the stock, as a trader might encounter with a thinly-traded stock. Fidelity Charitable was having no trouble trading WATT on December 29, 2017 when it was trading at nearly historically high volume and price.

All charities, including community foundations, need to be careful about statements to donors. Statements may be characterized as promises and promises may give rise to contracts with state law effects.

In Pinkert v. Schwab Charitable Fund, 2021 WL 2476869 (N. D. Ca. 2021), the claim was that Schwab operates investment pools that are more expensive than other similar investment pools which is a breach of Schwab’s fiduciary duty, as the opinion describes:

The plaintiff alleges that there are cheaper alternatives available for the index funds and the money-market fund. (For example, Vanguard has a cheaper money-market fund.) Also, investment funds have classes of shares that are more expensive for smaller investors with less bargaining power (akin to a retail price) and less expensive for institutional investors (a wholesale price). Schwab Charitable allegedly selected the retail shares of some funds when it could have qualified for the wholesale shares. In a similar vein, Schwab Charitable could have used its market power to negotiate better rates for the custodial and brokerage services that Charles Schwab provides it. The idea is that Schwab Charitable has benefited Charles Schwab to the detriment of the fund, leaving fewer dollars in donor accounts, including the plaintiff’s account, that can be donated to charitable organizations. (footnotes omitted)

The court denied standing because there was no allegation that Schwab promised certain investments which were not made, and the donor gave away the contribution to Schwab and was not a beneficiary of the charitable fund in any way that would create standing. The plaintiff also argued that the fees reduced the amount available to be given away which did reputational damage to the plaintiff, an argument the court rejected stating:

Third, the plaintiff contends that the defendants injured his “reputational and expressive interests” in his account. He uses the account to advance his philanthropic goals, support charities that are meaningful to his family, and cultivate the family value of charitable giving. The excess fees reduce his ability to advance those interests.24 He cites no analogous case to support this argument. Instead, he cites *Friends of the Earth* and *Spokeo.* The interests that establish standing in an environmental case (recreational, aesthetic, and economic) or a data-privacy case (harm to reputation) are not analogous. For one, standing is contextual, and the harm to a plaintiff-donor’s advisory or reputational interest is not injury in fact commensurate with the industrial pollution reducing recreational opportunities in *Friends of the Earth* or the inaccurate information in a consumer report that was injury in *Spokeo*. *Friends of the Earth, Inc. v. Laidlaw Envtl. Servs. (TOC), Inc.*, 528 U.S. 167, 181–84 (2000); *Robins v. Spokeo, Inc.*, 867 F.3d 1108, 1112 (9th Cir. 2017).

The case is on appeal to the 9th Circuit.

## **No Appraisal, No Deduction, But Yes, A Penalty**

. Pankratz v. Commissioner, T.C. Memo. 2021-26, involved multiple income tax issues but of particular interest was the charitable income tax deduction. The taxpayers gave to charity oil and gas interests, real estate, and a conference center, without any professional appraisals. The court denied charitable deduction. With respect to potential relief, the taxpayer’s tax filing process was key. The opinion describes that as follows:

Pankratz owned over 13,000 acres in seven counties in South Dakota. The bookkeeping for these was done by Jim Horning, one of Pankratz's longest serving employees. Horning had graduated from Briar Cliff College with a bachelor of arts degree in accounting, and done a brief stint at an accounting firm. He is not a CPA, attorney, or licensed tax preparer, but over the years his role grew to include paying and filing invoices, depositing checks, reconciling bank statements, and compiling and collecting other financial information. He also prepares information for Pankratz's income-tax return every year.

\* \* \*

Pankratz retained Wohlenberg Ritzman & Co.--the same accounting firm that has prepared his tax returns since the early 1970s--to do his 2008 and 2009 returns. Pankratz's goal for Wohlenberg was to compile a “good, honest income tax return.” Blaine Meier, a CPA and partner at Wohlenberg, had taken over as the primary preparer of Pankratz's tax returns starting in 2005, and was in charge of his 2008 and 2009 returns.

Meier had a standard procedure. A client would come into the office for a face-to-face meeting and discuss the tax information he brought with him. After going through the information, Meier (or a Wohlenberg staff member) would enter the information into tax-preparation software. Meier would then do a final review to make sure all of the information had been properly entered, the correct forms used, and the calculations checked--and give the return his final approval. He would then process and file the tax return.

His process for Pankratz, however, was different. Neither he nor the staff at Wohlenberg prepared the return directly. Instead, Horning gathered information and took it to Wohlenberg where Horning personally entered information into the firm's tax-preparation software. Meier testified, and we do find him credible on this point, that he himself would then review what Horning had prepared. We also find that Meier went form by form, and reviewed all the forms that were part of the return. Wohlenberg's software was also written to notify Meier of any issues so that he could raise with the client any issue that it flagged. Things were, again, a bit different with Pankratz. Meier didn't discuss any flagged issues with him, but with Horning. Horning was then supposed to discuss them with Pankratz. Meier said, and again we find him credible on this, that he never spoke to Pankratz directly because “he wasn't around.” After this indirect review, Meier would sign the return.

This roundabout way of return preparation had caused errors in the past. And we do find Pankratz was aware of these issues before he filed his 2008 and 2009 returns.

\* \* \*

Meier reviewed this return. Meier noticed the large noncash contributions listed on Form 8283 and noticed that no appraisals were attached. Meier raised this issue with Horning.[7](https://1.next.westlaw.com/Document/I3b2045c07cf311eba660be4ce62361b9/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default)#co_footnote_B00072053176326) But we also find credible the testimony that neither Meier nor Horning told Pankratz himself about this problem.

***\*6*** Despite this potential issue, Meier signed the return, and Horning filed it. Throughout this process Meier never met with Pankratz to discuss his return. And Pankratz never reviewed his 2008 return before it was filed, because it was filed a day or two before the deadline and he wasn't around.

\* \* \*

For the 2009 return the process was mostly the same. Horning compiled the information, went to Wohlenberg, and fed it into the firm's tax software. He recorded the donation of the conference center on Form 8283. He listed the donation as “CONFERENCE CENTER” in section B, part I of Form 8283. He left the appraised fair market value blank. He attached no appraisal to the return.

Meier again reviewed the return and again noticed that there was no appraisal attached to Form 8283. He again told Horning that this was a problem. This time, however, Horning called Pankratz and told him that he needed an appraisal if he wanted a deduction for his donation of the conference center.

Pankratz asked Horning if instead he could just deduct the cost of the building. Pankratz and Horning discussed it and finally decided this informal valuation would work. They valued the conference center at its cost. We specifically find that they didn't ask Meier whether this informal valuation was appropriate. As with the 2008 return, Pankratz never had a face-to-face meeting with Meier. He never spoke on the phone with Meier. And most importantly, he never reviewed the final return before it was filed shortly before it was due.

With that process as background, the court looked to see if there were reasonable cause for the failure to file an appraisal:

Pankratz concedes that he did not attach a qualified appraisal of either his oil and gas interests or the conference center to his returns. The complete denial of a deduction can be harsh, but this failure alone might be enough for us to deny the contested deductions. See sec. 170(f)(11)(A)(i). There is but one hope for Pankratz--section 170(f)(11)(A)(ii)(II). Congress, when it codified many of the old substantiation regulations in section 170(f)(11), added an escape hatch from nondeductibility for well-intentioned taxpayers. Section 170(f)(11)(A)(ii)(II) tells us not to deny a deduction for failure to comply with subparagraph (B), (C), or (D) “if it is shown that the failure to meet such requirements is due to reasonable cause and not to willful neglect.” Neither the Code nor the regulations tell us what “reasonable cause” means in this section, but “reasonable cause” is a phrase that one finds in a great many sections of the Code that provide for defenses to penalties and additions to tax. And we've already held that we should look to cases that apply those sections to give meaning to the term in this section. See Presley v. Commissioner, T.C. Memo. 2018-171, 116 T.C.M. (CCH) 387, 402 (2018), aff'd, 790 F. App'x 914 (10th Cir. 2019); Crimi v. Commissioner, T.C. Memo. 2013-51, 105 T.C.M. (CCH) 1330, 1353 (2013).

\* \* \*

Reasonable cause requires a taxpayer to exercise ordinary business care and prudence. See, e.g., United States v. Boyle, 469 U.S. 241, 246 (1985); Presley, 116 T.C.M. (CCH) at 402. Whether a taxpayer had reasonable cause is a fact-intensive inquiry that requires a case-by-case examination of all the facts and circumstances presented. Presley, 116 T.C.M. (CCH) at 402; Crimi, 105 T.C.M. (CCH) at 1353. Pankratz argues that he had reasonable cause for the position he took on his return because he reasonably relied on Meier's and Horning's advice. When a taxpayer claims to have relied on the advice of a professional, he must show that:

• the professional was a competent tax adviser with sufficient expertise to justify reliance,

• he provided necessary and accurate information to the professional who gave him advice, and

• he actually relied in good faith on that advice.

See Alt. Healthcare Advocates v. Commissioner, 151 T.C. 225, 246 (2018); Neonatology Assocs., P.A. v. Commissioner, 115 T.C. 43, 99 (2000), aff'd, 299 F.3d 221 (3d Cir. 2002).

1. Competent Tax Adviser

It is uncontested that Meier is a competent tax adviser with sufficient expertise to justify reliance. Whether Horning is a competent tax adviser with sufficient experience to justify reliance is a more difficult question.

There is no precise threshold of competence that a tax adviser must have to justify reliance. Our practical test looks for expertise commensurate with the facts of each case. CNT Inv'rs, LLC v. Commissioner, 144 T.C. 161, 224 (2015); see also Neonatology, 115 T.C. at 99 (insurance agent lacked sufficient expertise to advise on complex, group whole/term hybrid life insurance plan); Thousand Oaks Residential Care Home I, Inc. v. Commissioner, T.C. Memo. 2013-10, 105 T.C.M. (CCH) 1056, 1066 (2013) (longtime accountant who prepared tax returns full time, was an enrolled agent, and had a master's degree in business administration was competent professional to advise on employment-plan contributions).

When we apply this practical test, we find that Horning was not a competent tax adviser. He is not a CPA. He is not an attorney. He is not a full-time return preparer. He has no professional license of any kind. He is just a longtime employee who provides financial-related support to Pankratz and has a bachelor's degree in accounting. We are specifically not saying that a professional license is always required for a reliance defense to penalties, only that Horning's experience is not enough to make him competent to prepare a large and complex tax return which included information from over a dozen businesses and farms. Pankratz himself knew that his usual way of preparing returns for his businesses had led to understatements of tax in the past. And it leads us to find again, as we did in Kirman v. Commissioner, T.C. Memo. 2011-128, 101 T.C.M. (CCH) 1625, 1633 (2011), that a longtime preparer may not be a competent adviser on whom a taxpayer could reasonably rely.

\* \* \*

Here, we find that Pankratz did provide all necessary information to Meier, because the firm had all the working papers that Horning used to prepare the return. The irony is not lost on us that these cases focus around an appraisal that was not provided--which would seemingly indicate that Pankratz did not provide all necessary information. There's a subtle point here: We think it reasonable for Pankratz to not know before he prepared his return that he needed an appraisal. The last time he made a large, noncash contribution he hadn't attached an appraisal to his return and yet it had been accepted by the IRS. But we want to be careful about limiting this finding of reasonableness--we find only that it was reasonable for Pankratz to not know about this requirement when he first submitted information to the Meier firm.

\* \* \*

We first have to figure out whether Meier actually advised Pankratz that he didn't need an appraisal. The big problem for Pankratz here is that Meier told Horning that there needed to be an appraisal, yet neither Horning nor Pankratz nor anyone else ever got one. We do find Pankratz credible when he said that no one ever told him he needed an appraisal. And we acknowledge that Pankratz never had a face-to-face meeting with Meier or spoke with him over the phone. But this only makes it easier for us to find that Pankratz did not rely on Meier's advice.

Then there's the problem that Pankratz admitted that he never reviewed his return. A taxpayer's failure to review a return, though troubling, is not by itself fatal--there can be cases where even diligent taxpayers wouldn't be able to see a subtle problem in their tax returns. CNT Inv'rs, LLC, 144 T.C. at 234. That's not the case here.

We first look to Pankratz's education, sophistication, and business experience. He is very well educated, with both a college degree and a doctorate. And, although he tried to represent himself as a lowly farm hand, he is a sophisticated and savvy businessman--he was able to create Grand Labs from nothing and sell it for $85 million, and he then invested his money in several different ventures in several different states. He may lack formal tax training, but we find that he possesses a sharp and sophisticated mind for business. Had Pankratz simply looked at Form 8283 he would have noticed that, at the very least, he likely needed to get appraisals. This makes his case unlike CNT Investors, LLC, because there the taxpayer met with his adviser and his review of the return would not have shown any issues. See CNT Inv'rs, LLC, 114 T.C. at 234.

One does not have to be a tax expert to be able to read Form 8283. Had Pankratz reviewed that two-page form, he would have seen that it said “[a]n appraisal is generally required for property listed in Section B,” or “you must attach a qualified appraisal of the property,” or “[a]ppraised fair market value,” or “Declaration of Appraiser.” For a man as smart as Pankratz, this would have suggested that there was a potential major error on the return, and should have prompted him (at the very least) to ask Meier whether an appraisal was needed.[10](https://1.next.westlaw.com/Document/I3b2045c07cf311eba660be4ce62361b9/View/FullText.html?originationContext=typeAhead&transitionType=Default&contextData=(sc.Default)#co_footnote_B00102053176326) Instead, he just signed the return.

With neither advice nor good faith reliance on that advice, we deny the deduction for Pankratz's contribution of his interests in the oil and gas fields.

The bottom-line is that the court concluded a reasonable taxpayer would review his return and spot the language of the Form 8283 which clearly requires an appraisal. For the same reason, the court upheld a penalty too:

Our conclusion--that Pankratz lacked reasonable cause for omission of appraisals--was based on regulations and precedents under section 170(f)(11)(A)(ii)(II), which we used because caselaw tells us that the defense is the same for both sections. So it is. And we find in this context, and for the same reasons stated above, that Pankratz lacked reasonable cause claiming those deductions. Penalties apply here.

# **SECTION 408 —** **IRAs AND RETIREMENT PLANS**

## **SECURE Act Changes**

**.** Sections 114 and 401 of the Setting Every Community Up for Retirement Enhancement (“SECURE”) Act of 2019 contain a number of provisions important to estate planners primarily in connection with distributions from defined contribution plans (“plans”) and individual retirement accounts.

### Required Beginning Date Change

The term required beginning date (“RBD”) refers to the date when the plan participant or IRA owner (the “employee”) begins receiving required minimum distributions (“RMDs”) from the plan or IRA. Before the SECURE Act, the RBD was April 1 of the year following the year in which the employee reached age 70½ or, if not a 5% owner, retired, whichever was later. Section 114 of the SECURE Act, amending sections 401(a)(9)(B) & (C) and 408(b), changes the RBD for employees who reach age 70½ after December 31, 2019 to April 1 of the year following the year in which the employee reaches age 72 or, if not a 5% owner, retires, whichever is later. One result of this change is that no one will have an RBD in 2021.

This is a small positive development for taxpayers because, while there is no prohibition against or penalty for starting to receive distributions a year or two earlier than one’s RBD, those who can afford to defer starting to receive distributions until the new RBD may have as much as an extra year of tax-deferred earnings on the amount of their initial RMD.

### Introduction of “Eligible Designated Beneficiary” Concept

Section 401 of the SECURE Act, amending section 401(a)(9)(E), introduces the term “eligible designated beneficiary” (“EDB”). An EDB includes an employee’s surviving spouse, an employee’s child who has not reached majority (an employee’s child who has not completed a “specified course of education” is a minor but what such a course is, is uncertain; similarly, a child who has not attained age 26 appears to be a minor for these purposes), a “disabled” individual (within the meaning of section 72(m)(7)), a chronically ill individual (within the meaning of section 7702B(c)(2)) and an individual not more than ten years younger than the employee. An employee’s child who has reached majority is no longer an EDB. EDB status is determined as of the employee’s date of death.

### Minimum Required Distribution Rules Under SECURE Act

Before the SECURE Act, if the beneficiary of a defined contribution plan or IRA was a designated beneficiary (“DB”) (very simply, an individual who is designated as a beneficiary under the plan (or IRA)), RMDs could generally be made to the DB over his or her life expectancy. The opportunity to spread RMDs over a beneficiary's life expectancy was (and is) generally considered to be a positive attribute because it usually enables accumulation and compounding of tax-deferred earnings within the plan or IRA for a relatively long period.

The SECURE Act left the defined contribution plan and IRA distribution options pertaining to a surviving spouse largely unchanged. As before, a surviving spouse may elect to treat a predeceased spouse’s IRA as her or his own, implement a spousal rollover or take plan or IRA distributions over her or his life expectancy as annually recalculated. A surviving spouse may delay the start of distributions until the predeceased spouse would have reached age 72.

Also left undisturbed by the SECURE Act are the RMD rules applicable when there is no DB. In that case, if the employee dies before reaching his or her RBD, all plan or IRA proceeds must be distributed by the end of the fifth year after the year of the employee’s death, and, if the employee dies on or after reaching his or her RBD, all plan or IRA proceeds must be distributed over the employee’s then remaining life expectancy without annual recalculation.

However, under the SECURE Act, if and only if a plan or IRA beneficiary is an EDB, he or she may receive plan or IRA proceeds over his or her life expectancy (but, unless such beneficiary is the employee’s surviving spouse, without annual recalculation). If a plan or IRA beneficiary is a DB but not an EDB, that DB must take all plan or IRA proceeds by the end of the tenth year after the year of the employee’s death. These provisions are effective with respect to plans and IRAs where the employee died or dies after December 31, 2019.

### Summary of Trust Planning Under SECURE Act

A so-called “conduit trust” is a trust whose terms mandate that any and all distributions the trust receives from a plan or IRA pursuant to the applicable beneficiary designation shall be immediately paid over to the current beneficiary. A conduit trust is the ultimate “see-through trust” because, when determining the amounts of RMDs distributable from a plan or IRA to the trust, one simply looks to the identity and age of the current beneficiary.

If plan or IRA benefits are payable to a conduit trust for the benefit of the employee’s surviving spouse, those benefits may be paid over the annually recalculated life expectancy of the surviving spouse. Following the death of the surviving spouse, any remaining benefits will have to be paid no later than the end of the tenth year after the year of death of the surviving spouse.

If plan or IRA benefits are payable to a conduit trust for the benefit of a non-spousal EDB, those benefits may be paid over the life expectancy of the EDB without recalculation. Following the death of the non-spousal EDB, any remaining benefits will have to be paid no later than the end of the tenth year after the year of such death. The major exception to these rules, however, is that, if the non-spousal EDB is a minor child of the employee, the plan or IRA benefits payable to the conduit trust can no longer be paid over the EDB’s life expectancy (without recalculation) from and after the point when that child has reached majority. From and after that time, any remaining benefits will have to be paid no later than the end of the tenth year after the year in which the child reached majority. If plan or IRA benefits are payable to a conduit trust for the benefit of a DB who is not an EDB, those benefits will have to be paid no later than the end of the tenth year after the year of the employee’s death.

A so-called “accumulation trust” is a “see-through trust” whose terms do not require that any and all distributions the trust receives from a plan or IRA pursuant to the applicable beneficiary designation shall be paid over to any trust beneficiary at any particular time. A see-through trust is one that is valid under state law, irrevocable, has identifiable, human beneficiaries and as to which certain documentation is provided to the plan or IRA custodian or trustee by October 31 of the year after the employee’s death. See Treas. Reg. Section 1.401(a)(9)-4, A-5(b).

In general, if plan or IRA benefits are payable to an accumulation trust, those benefits will have to be paid no later than the end of the tenth year after the year of the employee’s death. The exceptions to this general rule are as follows:

* If the accumulation trust is for the benefit of a disabled individual or a chronically ill individual, (two categories of EDB as defined in amended section 401(a)(9)(E)) and has multiple beneficiaries, it is an “applicable multi-beneficiary trust” (“AMBT”). Plan or IRA benefits payable to an AMBT may be paid using the life expectancy method, but it is not entirely clear whether the measuring life is that of the disabled or chronically ill individual or another beneficiary.
* If one or more beneficiaries of the accumulation trust are non-DBs:
  + If the employee dies before his or her RBD, plan or IRA benefits will have to be paid no later than the end of the fifth year after the year of the employee’s death.
  + If the employee dies on or after his or her RBD, plan or IRA benefits may be paid over the employee’s then remaining life expectancy without recalculation.

## **Waiver of 2020 Required Minimum Distributions**

**.** The CARES Act (the “Coronavirus Aid, Relief and Economic Security Act”), signed by the President on March 27, 2020, includes a provision (Section 2203, amending sections 401(a)(9) & 402(c)(4)) granting a waiver of any and all defined contribution plan and IRA RMDs that, in the absence of the waiver, would have been required in 2020. Thus, amounts that would have been mandated RMDs for 2020 (even for those who reached age 70½ in 2019 and so would have been required to take two RMDs in 2020) were permitted instead to remain inside the plan or IRA in 2020 and continue to generate tax-deferred investment return.

On June 23, 2020, the IRS issued Notice 2020-51. Notice 2020-51 explicitly allows a recipient of a RMD in 2020 to roll it over – essentially reversing the transaction and its otherwise applicable tax consequences.

The timing of enactment of the CARES Act in relation to the 2020 RMD waiver it granted, however, created a dilemma for those employees who wanted to take advantage of the waiver but at the time of enactment or shortly thereafter had already taken their 2020 RMD and allowed sixty days to pass. To alleviate this problem, Notice 2020-51 also expanded the usual sixty-day rollover period so that any RMD received in 2020, regardless of when received in 2020, could be rolled over until August 31, 2020, at the earliest.

Other important provisions of the CARES Act include Section 2202, amending section 72, which allowed the following:

* A “qualified individual” could receive in-service “coronavirus-related distributions” from a plan or IRA of up to $100,000.00 from January 1, 2020 through December 30, 2020 without being subject to the 10% early distribution penalty if the recipient was under age 59½ and with the options to elect ratable income taxation of the amount distributed over a three-year period or to repay to the plan or IRA within three years the amount distributed as if the repayment were validly rolled-over in a trustee-to-trustee transfer within sixty days of the distribution. Qualified individuals are those who is diagnosed with SARS-CoV-2 or COVID-19, whose spouse or a dependent diagnosed with SARS-CoV-2 or COVID-19 or who experiences adverse financial consequences from being quarantined, furloughed or laid off, having work hours reduced, being unable to work due to lack of child care or closing or reducing the hours of a business owned or operated by such individual. This was an expansive group.
* A qualified individual could receive loans from a qualified plan of up to $100,000.00 or the employee’s nonforfeitable, accrued benefit (an increase in the loan limit from $50,000 or one-half of the employee’s nonforfeitable, accrued benefit) through September 22, 2020. See IRS Notice 2020-50. A plan sponsor may delay a qualified individual’s loan repayment obligation for one year. Subsequent repayments with respect to any such loan are required to be adjusted to reflect that delay and any interest accruing during that delay.

## **Transfer to Inherited IRA Denied**

. A taxpayer ended up in a bad situation in PLR 202125007. The facts were straightforward:

You represent that in Year 1, within months after Decedent A’s death, the custodian of IRA X advised Trust T’s trustees that they could not trade stocks in IRA X and that the assets of IRA X would have to be transferred to another account in order to trade stocks. Following the custodian’s advice, Trust T’s trustees transferred substantially all of IRA X’s assets to a non-IRA account held by the custodian for the benefit of Trust T.

Several months have passed since the transfer of IRA X’s assets to the non-IRA account. You request that the transfer be permitted to be reversed, so that the assets in the nonIRA account may be transferred to an inherited IRA account for the benefit of Trust T.

The IRS said no. The ruling states:

Assets in an inherited IRA for the benefit of a trust are not permitted to be rolled over under section 408(d)(3). The only permitted method of transferring assets from an inherited IRA to another inherited IRA is via a trustee-to-trustee transfer, which requires a direct transfer from one IRA to another IRA. Therefore, once the assets have been distributed from an inherited IRA, there is no permitted method of transferring them back into an IRA. In this case, the assets of IRA X were transferred to a non-IRA account. Accordingly, the assets may not now be transferred to an IRA account.

With regard to your second ruling request, section 408(d) provides that, except with respect to investment in the contract, assets distributed out of an inherited IRA are included in gross income. Accordingly, Trust T will be required to include in gross income for Year 1, the year in which the distribution from IRA X occurred, any portion of the amounts transferred from IRA X that is not investment in the contract.

With regard to your third ruling request, as also set forth in the first ruling, Trust T may not transfer IRA X’s assets currently held in the non-IRA account into any IRA account.

# SECTIONS 671-678 -- GRANTOR TRUST RULES

## **Section 678 and a Presently Exercisable General Power of Appointment As A Planning Device**

. Section 678 provides:

(a) General Rule. —A person other than the grantor shall be treated as the owner of any portion of a trust with respect to which:

(1) such person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself, or

(2) such person has previously partially released or otherwise modified such a power and after the release or modification retains such control as would, within the principles of sections 671 to 677, inclusive, subject a grantor of a trust to treatment as the owner thereof.

(b) Exception Where Grantor Is Taxable. Subsection (a) shall not apply with respect to a power over income, as originally granted or thereafter modified, if the grantor of the trust or a transferor (to whom section 679 applies) is otherwise treated as the owner under the provisions of this subpart other than this section.

[emphasis added]

Section 678(a)(2) has long been the basis for estate tax planning: a parent contributes $5000 to a trust that gives the child a 30 day withdrawal right and gives the child other powers that would have made the trust a grantor trust if the child had contributed the $5000 to the trust. The child would appear to be the owner of the entire trust (assuming that parent has no rights in the trust that would make the parent the grantor) and thus Rev. Rul. 85-13 would treat the child and the trust as the same taxpayer. Such trusts are often referred to as BDITs – Beneficiary Deemed Inheritor’s Trusts – and have been the subject of wide discussion and controversy. See, e.g., Jerome M. Hesch, Lawrence Brody, Richard A. Oshins & Susan P. Rounds, *A Gift From Above: Estate Planning on a Higher Plane — The Unique Design of a BDIT Minimizes — Even Eliminates — Many Tax and Non-Tax Problems*, 150 Tr. & Est. 17 (Nov. 2011); but also Rev. Proc. 2021-3, Section 4 (42) which provides:

(42) Section 678.—Person Other than Grantor Treated as Substantial Owner.— Whether a person will be treated as the owner of any portion of a trust over which that person has a power to withdraw the trust property (or had such power prior to a release or modification, but retains other powers which would cause that person to be the owner of the trust under § 671 if the person were the grantor), other than a power which would constitute a general power of appointment within the meaning of § 2041. if the trust purchases the property from that person with a note and the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

Section 678(a)(1) has given rise to a different kind of planning. Suppose a beneficiary may withdraw an amount equal to all of the trust's taxable income in any given year (from all of the trust assets) but not the entire trust assets. Ed Morrow refers to this as the BDOT; IRC 678(a)(1) the "*Beneficiary Deemed Owner Trust*" (BDOT), LEIMBERG ESTATE PLANNING NEWSLETTER #2516 (Sept. 5, 2017). The BDOT appears clearly effective for income shifting, but it is not quite as clear whether it makes the person with the right to withdraw the owner of the entire trust for Rev. Rul. 85-13 purposes.

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

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

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

What happens if the power is not exercised, as will often be the case? The trust agreement may provide that failure to withdraw the taxable income amount in a particular year would lapse and could not be exercised in a later year. If so, and if the lapsed power exceeds the greater of "(A) $5,000, or (B) 5 percent of the aggregate value, at the time of such lapse, of the assets out of which, or the proceeds of which, the exercise of the lapsed powers could have been satisfied," the power holder will be treated as having made a gift of the excess amount (unless it is an incomplete gift because of retained powers over the trust), which will mean the property will be included in the powerholder’s estate. Note that if the person with the withdrawal right is not an individual the “5 x 5 exception” may not apply; section 2514(e), which creates the exception, applies by its term to an “individual.”

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

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

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

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

**(a)** When a grantor or another [person](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=54ba1aba0c8d0e3ab0b5352283ef7f78&term_occur=1&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) is treated under subpart E (section 671 and following) as the [owner](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=85307a11a6f904ecc097fcc4cd8a417f&term_occur=1&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) of any portion of a [trust](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=51508d26cc4b7c4c977788a33dd0fdcc&term_occur=1&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3), there are included in computing his [tax liability](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=f7fdf9f43371a6f4fa9a885b4b1cb9af&term_occur=1&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) those items of [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=2&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3), deduction, and credit against tax attributable to or included in that portion. For example:

**(1)** If a grantor or another [person](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=54ba1aba0c8d0e3ab0b5352283ef7f78&term_occur=2&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) is treated as the [owner](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=85307a11a6f904ecc097fcc4cd8a417f&term_occur=2&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) of an entire [trust](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=51508d26cc4b7c4c977788a33dd0fdcc&term_occur=2&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) (corpus as well as ordinary income), he takes into [account](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=c3b57a31fc226d7b84e26175afe251f2&term_occur=1&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) in computing his [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=3&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) [tax liability](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=f7fdf9f43371a6f4fa9a885b4b1cb9af&term_occur=2&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) all items of [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=4&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3), deduction, and credit (including [capital gains](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=aae472b567944759a246f16bc39664e7&term_occur=1&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) and losses) to which he would have been entitled had the [trust](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=51508d26cc4b7c4c977788a33dd0fdcc&term_occur=3&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) not been in existence during the period he is treated as [owner](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=85307a11a6f904ecc097fcc4cd8a417f&term_occur=3&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3).

**(2)** If the portion treated as owned consists of specific [trust](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=51508d26cc4b7c4c977788a33dd0fdcc&term_occur=4&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) [property](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=bba09cadb5ff01866e924e352f3370d2&term_occur=1&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) and its [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=5&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3), all items directly related to that [property](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=bba09cadb5ff01866e924e352f3370d2&term_occur=2&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) are attributable to the portion. Items directly related to [trust](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=51508d26cc4b7c4c977788a33dd0fdcc&term_occur=5&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) [property](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=bba09cadb5ff01866e924e352f3370d2&term_occur=3&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) not included in the portion treated as owned by the grantor or other [person](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=54ba1aba0c8d0e3ab0b5352283ef7f78&term_occur=3&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) are governed by the provisions of subparts A through D (section 641 and following), part I, subchapter J, chapter 1 of the Code. Items that relate both to the portion treated as owned by the grantor and to the balance of the [trust](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=51508d26cc4b7c4c977788a33dd0fdcc&term_occur=6&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) must be apportioned in a manner that is reasonable in the light of all the circumstances of each case, including the [terms](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=6e02ab47b6e9584ede0a067339f05a6f&term_occur=1&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) of the governing instrument, local law, and the practice of the [trustee](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=543b5d223089f6209c32c47891af84f4&term_occur=1&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) if it is reasonable and consistent.

**(3)** If the portion of a [trust](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=51508d26cc4b7c4c977788a33dd0fdcc&term_occur=7&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) treated as owned by a grantor or another [person](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=54ba1aba0c8d0e3ab0b5352283ef7f78&term_occur=4&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) consists of an undivided fractional [interest](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=8e83046407fe273f9396d8e57f9d27a9&term_occur=1&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) in the [trust](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=51508d26cc4b7c4c977788a33dd0fdcc&term_occur=8&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3), or of an [interest](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=8e83046407fe273f9396d8e57f9d27a9&term_occur=2&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) represented by a dollar [amount](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=e805341e826e50dbe8e45d3226829f67&term_occur=1&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3), a pro rata share of each item of [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=6&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3), deduction, and credit is normally allocated to the portion. Thus, where the portion owned consists of an [interest](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=8e83046407fe273f9396d8e57f9d27a9&term_occur=3&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) in or a right to an [amount](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=e805341e826e50dbe8e45d3226829f67&term_occur=2&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) of corpus only, a fraction of each item (including items allocated to corpus, such as capital gains) is attributed to the portion. The numerator of this fraction is the [amount](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=e805341e826e50dbe8e45d3226829f67&term_occur=3&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) which is subject to the [control](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=e2f4cef7f1a92fdc4cf8c7071865a26c&term_occur=1&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) of the grantor or other [person](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=54ba1aba0c8d0e3ab0b5352283ef7f78&term_occur=5&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) and the denominator is normally the [fair market value](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=a02bfd330744dda8ac236666bad7d738&term_occur=1&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) of the [trust](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=51508d26cc4b7c4c977788a33dd0fdcc&term_occur=9&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) corpus at the beginning of the [taxable year](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=8a2837bd45f19a50d5183d6f43bb65dc&term_occur=1&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) in question. The share not treated as owned by the grantor or other [person](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=54ba1aba0c8d0e3ab0b5352283ef7f78&term_occur=6&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) is governed by the provisions of subparts A through D. See the last three sentences of [paragraph (c)](https://www.law.cornell.edu/cfr/text/26/1.671-3#c) of this section for the principles applicable if the portion treated as owned consists of an [interest](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=8e83046407fe273f9396d8e57f9d27a9&term_occur=4&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) in part of the ordinary [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=7&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) in contrast to an [interest](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=8e83046407fe273f9396d8e57f9d27a9&term_occur=5&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) in corpus alone.

**(b)** If a grantor or another [person](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=54ba1aba0c8d0e3ab0b5352283ef7f78&term_occur=7&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) is treated as the [owner](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=85307a11a6f904ecc097fcc4cd8a417f&term_occur=4&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) of a portion of a [trust](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=51508d26cc4b7c4c977788a33dd0fdcc&term_occur=10&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3), that portion may or may not include both ordinary [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=8&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) and [other income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=a1090209155963fa1ccc27347b494f36&term_occur=1&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) allocable to corpus. For example:

**(1)** Only ordinary [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=9&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) is included [by reason of](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=ae27f114d4ac9f51e367eab1be1b4c32&term_occur=1&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) an [interest](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=8e83046407fe273f9396d8e57f9d27a9&term_occur=6&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) in or a power over ordinary [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=10&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) alone. Thus, if a grantor is treated under section 673 as an [owner](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=85307a11a6f904ecc097fcc4cd8a417f&term_occur=5&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) [by reason of](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=ae27f114d4ac9f51e367eab1be1b4c32&term_occur=2&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) a reversionary [interest](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=8e83046407fe273f9396d8e57f9d27a9&term_occur=7&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) in ordinary [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=11&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) only, items of [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=12&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) allocable to corpus will not be included in the portion he is treated as owning. Similarly, if a grantor or another [person](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=54ba1aba0c8d0e3ab0b5352283ef7f78&term_occur=8&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) is treated under sections 674-678 as an [owner](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=85307a11a6f904ecc097fcc4cd8a417f&term_occur=6&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) of a portion [by reason of](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=ae27f114d4ac9f51e367eab1be1b4c32&term_occur=3&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) a power over ordinary [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=13&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) only, items of [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=14&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) allocable to corpus are not included in that portion. (See [paragraph (c)](https://www.law.cornell.edu/cfr/text/26/1.671-3#c) of this section to determine the [treatment](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=6a592770ebf690a6144170fdcf3dac0d&term_occur=1&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) of [deductions](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=f917901de6379998342cf498d0de4ad0&term_occur=2&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) and credits when only ordinary [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=15&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) is included in the portion.)

**(2)** Only [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=16&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) allocable to corpus is included [by reason of](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=ae27f114d4ac9f51e367eab1be1b4c32&term_occur=4&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) an [interest](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=8e83046407fe273f9396d8e57f9d27a9&term_occur=8&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) in or a power over corpus alone, if satisfaction of the [interest](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=8e83046407fe273f9396d8e57f9d27a9&term_occur=9&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) or an [exercise](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=970d2414a1a31dbe5eef288e0a9bfa3c&term_occur=1&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) of the power will not [result](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=8fc1e1636dc887fa2eb5285e292a8cd2&term_occur=1&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) in an [interest](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=8e83046407fe273f9396d8e57f9d27a9&term_occur=10&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) in or the [exercise](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=970d2414a1a31dbe5eef288e0a9bfa3c&term_occur=2&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) of a power over ordinary [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=17&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) which would itself cause that [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=18&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) to be included. For [example](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=7fbbc5e7cba0fa3a45979e5001d3ef7f&term_occur=1&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3), if a grantor has a reversionary [interest](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=8e83046407fe273f9396d8e57f9d27a9&term_occur=11&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) in a [trust](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=51508d26cc4b7c4c977788a33dd0fdcc&term_occur=11&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) which is not such as to require that he be treated as an [owner](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=85307a11a6f904ecc097fcc4cd8a417f&term_occur=7&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) under section 673, he may nevertheless be treated as an [owner](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=85307a11a6f904ecc097fcc4cd8a417f&term_occur=8&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) under section 677(a)(2) since any [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=19&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) allocable to corpus is accumulated for future distribution to him, but items of [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=20&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) included in determining ordinary [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=21&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) are not included in the portion he is treated as owning. Similarly, he may have a power over corpus which is such that he is treated as an [owner](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=85307a11a6f904ecc097fcc4cd8a417f&term_occur=9&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) under section 674 or 676 [(a)](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=e1dddec1bf76d3c791454723bed8673c&term_occur=1&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3), but ordinary [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=22&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) will not be included in the portion he owns, if his power can only affect [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=23&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) received after a period of time such that he would not be treated as an [owner](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=85307a11a6f904ecc097fcc4cd8a417f&term_occur=10&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) of the [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=24&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) if the power were a reversionary [interest](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=8e83046407fe273f9396d8e57f9d27a9&term_occur=12&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3). (See [paragraph (c)](https://www.law.cornell.edu/cfr/text/26/1.671-3#c) of this section to determine the [treatment](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=6a592770ebf690a6144170fdcf3dac0d&term_occur=2&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) of [deductions](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=f917901de6379998342cf498d0de4ad0&term_occur=3&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) and credits when only [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=25&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) allocated to corpus is included in the portion.)

**(3)** Both ordinary [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=26&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) and [other income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=a1090209155963fa1ccc27347b494f36&term_occur=2&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) allocable to corpus are included [by reason of](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=ae27f114d4ac9f51e367eab1be1b4c32&term_occur=5&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) an [interest](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=8e83046407fe273f9396d8e57f9d27a9&term_occur=13&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) in or a power over both ordinary [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=27&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) and corpus, or an [interest](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=8e83046407fe273f9396d8e57f9d27a9&term_occur=14&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) in or a power over corpus alone which does not come within the provisions of subparagraph (2) of this paragraph. For [example](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=7fbbc5e7cba0fa3a45979e5001d3ef7f&term_occur=2&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3), if a grantor is treated under section 673 as the [owner](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=85307a11a6f904ecc097fcc4cd8a417f&term_occur=11&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) of a portion of a [trust](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=51508d26cc4b7c4c977788a33dd0fdcc&term_occur=12&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) [by reason of](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=ae27f114d4ac9f51e367eab1be1b4c32&term_occur=6&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) a reversionary [interest](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=8e83046407fe273f9396d8e57f9d27a9&term_occur=15&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) in corpus, both ordinary [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=28&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) and [other income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=a1090209155963fa1ccc27347b494f36&term_occur=3&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) allocable to corpus are included in the portion. Further, a grantor includes both ordinary [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=29&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) and [other income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=a1090209155963fa1ccc27347b494f36&term_occur=4&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) allocable to corpus in the portion he is treated as owning if he is treated under section 674 or 676 as an [owner](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=85307a11a6f904ecc097fcc4cd8a417f&term_occur=12&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) because of a power over corpus which can affect [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=30&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) received within a period such that he would be treated as an [owner](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=85307a11a6f904ecc097fcc4cd8a417f&term_occur=13&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) under section 673 if the power were a reversionary [interest](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=8e83046407fe273f9396d8e57f9d27a9&term_occur=16&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3). Similarly, a grantor or another [person](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=54ba1aba0c8d0e3ab0b5352283ef7f78&term_occur=9&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) includes both ordinary [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=31&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) and [other income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=a1090209155963fa1ccc27347b494f36&term_occur=5&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) allocable to corpus in the portion he is treated as owning if he is treated as an [owner](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=85307a11a6f904ecc097fcc4cd8a417f&term_occur=14&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) under section 675 or 678 because of a power over corpus.

**(c)** If only [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=32&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) allocable to corpus is included in computing a grantor's [tax liability](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=f7fdf9f43371a6f4fa9a885b4b1cb9af&term_occur=4&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3), he will take into [account](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=c3b57a31fc226d7b84e26175afe251f2&term_occur=2&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) in that [computation](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=753ecf1b19d24b3ea05bc76f6f9171b1&term_occur=1&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) only those items of [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=33&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3), [deductions](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=f917901de6379998342cf498d0de4ad0&term_occur=4&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3), and credit which would not be included under subparts A through D in the [computation](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=753ecf1b19d24b3ea05bc76f6f9171b1&term_occur=2&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) of the [tax liability](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=f7fdf9f43371a6f4fa9a885b4b1cb9af&term_occur=3&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) of the current [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=34&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) beneficiaries if all [distributable net income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=bb14908bddb930afb0bea7fe0606316b&term_occur=1&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) had actually been distributed to those beneficiaries. On the other hand, if the grantor or another [person](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=54ba1aba0c8d0e3ab0b5352283ef7f78&term_occur=10&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) is treated as an [owner](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=85307a11a6f904ecc097fcc4cd8a417f&term_occur=15&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) solely because of his [interest](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=8e83046407fe273f9396d8e57f9d27a9&term_occur=17&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) in or power over ordinary [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=35&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) alone, he will take into [account](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=c3b57a31fc226d7b84e26175afe251f2&term_occur=3&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) in computing his [tax liability](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=f7fdf9f43371a6f4fa9a885b4b1cb9af&term_occur=5&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) those items which would be included in computing the [tax liability](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=f7fdf9f43371a6f4fa9a885b4b1cb9af&term_occur=6&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) of a current [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=36&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) [beneficiary](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=3ed0119947cfa6b0cca603e2e59b3ba7&term_occur=1&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3), including expenses allocable to corpus which enter into the [computation](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=753ecf1b19d24b3ea05bc76f6f9171b1&term_occur=3&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) of [distributable net income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=bb14908bddb930afb0bea7fe0606316b&term_occur=3&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3). If the grantor or other [person](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=54ba1aba0c8d0e3ab0b5352283ef7f78&term_occur=11&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) is treated as an [owner](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=85307a11a6f904ecc097fcc4cd8a417f&term_occur=16&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) because of his power over or right to a dollar [amount](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=e805341e826e50dbe8e45d3226829f67&term_occur=4&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) of ordinary [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=40&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3), he will first take into [account](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=c3b57a31fc226d7b84e26175afe251f2&term_occur=4&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) a portion of those items of [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=37&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) and expense entering into the [computation](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=753ecf1b19d24b3ea05bc76f6f9171b1&term_occur=4&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) of ordinary [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=38&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) under the [trust](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=51508d26cc4b7c4c977788a33dd0fdcc&term_occur=13&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) instrument or local law sufficient to produce [income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=1c07283120860b02c14e93d17bce07df&term_occur=39&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) of the dollar [amount](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=e805341e826e50dbe8e45d3226829f67&term_occur=5&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) required. There will then be attributable to him a pro rata portion of other items entering into the [computation](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=753ecf1b19d24b3ea05bc76f6f9171b1&term_occur=5&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) of [distributable net income](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=bb14908bddb930afb0bea7fe0606316b&term_occur=2&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) under subparts A through D, such as expenses allocable to corpus, and a pro rata portion of credits of the [trust](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=51508d26cc4b7c4c977788a33dd0fdcc&term_occur=14&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3). For [examples](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=d5a9c3642e246b82f79873865d396275&term_occur=1&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) of [computations](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=753ecf1b19d24b3ea05bc76f6f9171b1&term_occur=6&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) under this paragraph, see paragraph [(g)](https://www.law.cornell.edu/definitions/index.php?width=840&height=800&iframe=true&def_id=25302f42315815ddf27a930ab6743b6f&term_occur=1&term_src=Title:26:Chapter:I:Subchapter:A:Part:1:Subjgrp:10:1.671-3) of [§ 1.677(a)-1](https://www.law.cornell.edu/cfr/text/26/1.677#a_-1).

Where one trust can withdraw all of the assets of the other trust, the trust with the withdrawal right seems clearly the owner of the whole trust for income tax purposes. But with a more limited withdrawal right the result is uncertain. An example of a power to vest “the income therefrom” is described in Private Letter Ruling 201633021. The ruling involved Trust 1 and Trust 2 which were non-grantor trusts because the grantor had died. The assets of Trust 1 and Trust 2 are held for the benefit of the same beneficiaries. The governing document of Trust 2 provides that Trust 1 retains the power, solely exercisable by Trust 1, to revest the net income of Trust 2 in Trust 1; provided, however, that such power shall lapse on the last day of such calendar year. Trust 2 further provides that income includes (i) any dividends, interest, fees and other amounts characterized as income under section 643(b) of the Code, (ii) any net capital gains realized with respect to assets held less than twelve months, and (iii) any net capital gains realized with respect to assets held longer than twelve months. The ruling provides that the trustee “proposes to transfer funds from Trust 1 to Trust 2.”

The IRS concluded, “Trust 1 will be treated as the owner of the portion of Trust 2 over which they have the power to withdraw under § 678(a). Accordingly, Trust 1 will take into account in computing their tax liability those items which would be included in computing the tax liability of a current income beneficiary, including expenses allocable to which enter into the computation of distributable net income. Additionally, Trust 1 will also take into account the net capital gains of Trust 2.” The ruling unfortunately does not provide any insight on what the income tax consequences would be when Trust 1 “transfers funds” to Trust 2. The language of the ruling implies the Trust 1 will be treated as a beneficiary of Trust 2 but also “as the owner of the portion of Trust 2 over which they have the power to withdraw under § 678(a).”

The language doesn’t necessarily (but it could) mean that Trust 1 is the deemed owner entirely of Trust 2 and all of its assets. If Trust 1 is treated as the owner entirely of Trust 2, then theoretically Trust 1 could engage in a sale of the assets of Trust 1 to Trust 2 in exchange for an installment note, and the transaction would be disregarded for income tax purposes under Revenue Ruling 85-13. This would be the result if Trust one could withdraw all the assets of Trust 2 at any time.

If, however, Trust 1 is merely an entity that must report the income, capital gain, expenses, and other items used to compute DNI, then such a transaction could, in part, be considered a taxable event. Even if the latter interpretation is correct, if Trust 1 is a non-GST exempt trust and Trust 2 is a GST exempt trust, the tax liability borne by Trust 1 from all of Trust 2’s income and capital gain could significantly increase Trust 2’s trust assets over time and decrease the assets in Trust 1.

In a more recent ruling, PLR 202022002, the trust agreement of a Trust 1 prohibited the distribution of Shares (perhaps of a closely-held company) to the beneficiaries, but allowed for the distribution of the proceeds from the sale of Shares. Trust 1 contributed all of its Shares to LLC, a newly formed entity classified as partnership for Federal tax purposes, in exchange for membership interest in LLC. The same restrictions on the Shares were placed on the membership interests of LLC. Trust 1 then transferred a portion of its LLC interest to a Subtrust for the sole benefit of A. After A reached the age of 40, A exercised a withdrawal right to take all of the Subtrust’s assets, except the LLC interests. The Subtrust agreed to sell a portion of its LLC interests to Trust 2 in exchange for cash and a promissory note. Trust 2 is a grantor trust with respect to A. A also had the authority to withdraw the cash and promissory note from Subtrust after the sale. The IRS concluded, “because A has a power exercisable by herself to vest the proceeds of Subtrust’s LLC interest in herself and that those proceeds are Subtrust’s only asset, A will be treated as the owner of Subtrust under § 678. Consequently, the transfer of the LLC interests to Trust 2 is not recognized as a sale for federal income tax purposes because Trust 2 and Subtrust are both wholly owned by A.”

## **Grantor Trusts and Spouses**

. PLR 201927003 is helpful. Each spouse created a grantor trust. Then spouse one sold a partnership interest to spouse two’s trust, and Trust One sold interests to Trust Two. The ruling provides:

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

## **DING Trusts**

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

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

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

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

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

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

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

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

Grantor is the only donor and all property contributed to Trust will be Grantor's separate property under State 1 law. The trustee, Trustee, is a trust company with its headquarter in State 2. Trust is governed by the laws of State 2. Currently, Grantor and Spouse have two minor children, Child 1 and Child 2.

During Grantor's lifetime, at any time or times, Trustee, pursuant to an appointment of the Committee or Grantor, while the Committee is in existence, shall distribute to the Beneficiaries such amounts of net income or principal of Trust as the Committee or Grantor determines. Any appointment, determination, or action by the Committee requires either (i) The unanimous written consent of the then serving members of the Committee, other than Grantor (Unanimous Member Power), or (ii) The written consent of Grantor and a majority of the other then serving members of the Committee (Grantor's Consent Power). In addition, Grantor, in a non-fiduciary capacity, may appoint such amounts of principal to one or more persons in the group consisting of Grantor's descendants, Father, Mother, and Individual, as Grantor deems advisable to provide for such person's health, support, and education. (Grantor's Sole Power). Such power may not be exercised to discharge or satisfy Grantor's legal obligations. Any net income not distributed shall be accumulated and added to the principal of Trust.

If at any time a Committee member fails or ceases to serve then the position of such Committee member shall remain vacant; subject to exception for the appointment of representatives with legal authority to act on behalf of another Committee member.

The Trust agreement provides that if there is no Committee, the trustee (other than a beneficiary-trustee) may pay any one or more of the beneficiaries such amount or amounts of the net income and principal for any purpose, even to the extent of all or none, at any time and from time to time, as the trustee determines in his discretion and only with Grantor's written consent, and in making such determinations, the trustee may consider or ignore, in the trustee's discretion, the beneficiaries' other financial resources of any kind.

Initially, Committee consists of Grantor, Representative 1, Representative 2, Father, and Mother. Representatives 1 and 2 act on behalf of Child 1 and Child 2, respectively, until each child reaches majority age. As each of the minor children, Child 1 and Child 2, reaches majority age, that child will become a member of the Committee, replacing his representative. Trust provides that, at any time, members of the Committee, may by unanimous vote add one or more members to the Committee (other than Spouse) provided that such members are beneficiaries of Trust. The Trust agreement, as amended, states that Committee shall be deemed not to exist at any time there are fewer than two members other than Grantor. The Committee shall also be dissolved and cease to exist upon Grantor's death.

Upon Grantor's death, the trustee shall distribute such amounts of trust property as Grantor appoint to or in favor of any one person or more persons or entities, other than Grantor, Grantor's estate, the creditors of Grantor, or the creditors of Grantor's estate, as Grantor may appoint by will (Grantor's Testamentary Power). Such power may not be exercised to discharge or satisfy Grantor's legal obligations.

Upon Grantor's death, the trustee shall divide the then remaining trust property into as many separate shares of equal value as necessary to dispose of the property. Any balance which is not distributed pursuant to Grantor's Testamentary Power shall be distributed as follows: (1) one such equal share to Father, if he is then living; (2) one such equal share to Mother, if she is then living; (3) one such equal share to Individual, if he is then living, and (4) seven such equal shares to Grantor's then living descendants, by right of representation, to be held in further trust for such descendants. If none of the remainder beneficiaries is living upon Grantor's death, any balance which is not distributed pursuant to Grantor's Testamentary Power shall be distributed in equal shares in further trust for the benefit of individuals named in Trust.

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

In this case, Grantor retained the Grantor's Consent Power over the net income and principal of Trust. Under [§ 25.2511-2(e)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000547&cite=26CFRS25.2511-2&originatingDoc=Icd97d8329ef011e89a6efc60af1b5d9c&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)#co_pp_7fdd00001ca15), a donor is considered as himself having a power if it is exercisable by him in conjunction with any person not having a substantial adverse interest in the disposition of the transferred property or the income therefrom. The Committee members are not takers in default for purposes of [§ 25.2514-3(b)(2)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000547&cite=26CFRS25.2514-3&originatingDoc=Icd97d8329ef011e89a6efc60af1b5d9c&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)#co_pp_c0ae00006c482). They are merely co-holders of the power. Under [§ 25.2514-3(b)(2)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000547&cite=26CFRS25.2514-3&originatingDoc=Icd97d8329ef011e89a6efc60af1b5d9c&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)#co_pp_c0ae00006c482), a co-holder of a power is only considered as having an adverse interest where he may possess the power after the possessor's death and may exercise it at that time in favor of himself, his estate, his creditors, or the creditors of his estate. In this case, the Committee ceases to exist upon the death of Grantor. Accordingly, the Committee members do not have interests adverse to Grantor under [§ 25.2514-3(b)(2)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000547&cite=26CFRS25.2514-3&originatingDoc=Icd97d8329ef011e89a6efc60af1b5d9c&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)#co_pp_c0ae00006c482) and for purposes of [§ 25.2511-2(e)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000547&cite=26CFRS25.2511-2&originatingDoc=Icd97d8329ef011e89a6efc60af1b5d9c&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)#co_pp_7fdd00001ca15). Therefore, Grantor is considered as possessing the power to distribute net income and principal to any beneficiary himself because he retained the Grantor's Consent Power.

If the Committee ceases to exist, the Trustee has the power to distribute net income to a beneficiary. However, the Trustee's power is not a condition precedent to each Grantor's Consent Power. Each Grantor's Consent Power over income is presently exercisable and not subject to a condition precedent. Thus, the Trustee's power to distribute net income does not cause the transfer of property to be complete with respect to the income interest in Trust for federal gift tax purposes. Therefore, each Grantor is considered as possessing the power to distribute income to any beneficiary himself or herself because he or she retained the Grantor's Consent Power.

Grantor also retained the Grantor's Sole Power over the principal of Trust. Under [§ 25.2511-2(c)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000547&cite=26CFRS25.2511-2&originatingDoc=Icd97d8329ef011e89a6efc60af1b5d9c&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)#co_pp_4b24000003ba5), a gift is incomplete if and to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves unless the power is a fiduciary power limited by a fixed or ascertainable standard. In this case, the Grantor's Sole Power gives Grantor the power to change the interests of the beneficiaries. Even though Grantor's power is limited by an ascertainable standard, i.e., health, education, and support, Grantor's power is not a fiduciary power. Accordingly, the retention of the Grantor's Consent Power and the Grantor's Sole Power causes the transfer of property to Trust to be incomplete for federal gift tax purposes.

If the Committee ceases to exist, the Trustee, in its fiduciary capacity, also has the power to distribute principal to one or more beneficiaries. The powers of the Trustee are not conditions precedent to the Grantor's powers. Grantor's Sole Power over principal is presently exercisable and not subject to a condition precedent. Accordingly, Grantor retains dominion and control over the principal of Trust until the Trustee exercises his or her power to appoint principal. *See* [*Goldstein v. Commissioner*, 37 T.C. 897 (1962)](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1962001259&pubNum=0000838&originatingDoc=Icd97d8329ef011e89a6efc60af1b5d9c&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)). Thus, the Trustee's powers to distribute principal do not cause the transfer of property to be complete with respect to the remainder in Trust for federal gift tax purposes. Accordingly, the retention of Grantor's Consent Power and Grantor's Sole Power causes the transfer of property to Trust to be wholly incomplete for federal gift tax purposes.

Further, Grantor retained the Grantor's Testamentary Power to appoint the property in Trust to any persons, other than to the Grantor's estate, Grantor's creditors, or the creditors of Grantor's estate. Under [§ 25.2511-2(b)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000547&cite=26CFRS25.2511-2&originatingDoc=Icd97d8329ef011e89a6efc60af1b5d9c&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)#co_pp_a83b000018c76), the retention of a testamentary power to appoint the remainder of a trust is considered a retention of dominion and control over the remainder. Accordingly, the retention of this power causes the transfer of property to Trust to be incomplete with respect to the remainder for federal tax purposes.

Finally, the Committee members possess the Unanimous Member Power over net income and principal. This power is not a condition precedent to Grantor's powers. Grantor's powers over the net income and principal are presently exercisable and not subject to a condition precedent. Grantor retains dominion and control over the net income and principal of Trust until the Committee members exercise their Unanimous Member Power. Accordingly, the Unanimous Member Power does not cause the transfer of property to be complete with respect to the income interest for federal gift tax purposes. *See* [*Goldstein v. Commissioner*, 37 T.C. 897 (1962)](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1962001259&pubNum=0000838&originatingDoc=Icd97d8329ef011e89a6efc60af1b5d9c&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)); [*Estate of Goelet v. Commissioner*, 51 T.C. 352 (1968)](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1968290190&pubNum=0000838&originatingDoc=Icd97d8329ef011e89a6efc60af1b5d9c&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.Search)).

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

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

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

On Date, Settlor created Trust, an irrevocable trust, for the benefit of Individual A, Individual B, and Foundation (Eligible Beneficiaries). Trust has an Independent Trustee and an Administrative Trustee. The situs of Trust is State.

Article I(1) of Trust provides that during the life of Settlor, the trustees shall pay so much, if any, of the net income from such trust to or for the benefit of any one or more of the Eligible Beneficiaries, in such equal or unequal shares and to the exclusion of any one or more of the other Eligible Beneficiaries, as the Distribution Committee shall, at any time or from time to time by written instrument delivered to the trustees, direct; provided, however, that the trustees shall not distribute any amount to any of the Eligible Beneficiaries pursuant to any direction of the Distribution Committee unless and until Settlor shall, acting individually and solely in a nonfiduciary capacity, first consent in writing to such direction (Settlor’s Consent Power).

Article I(2) provides that the trustees shall be authorized to distribute all or any part of the net income not so paid pursuant to Article I(1) to any one or more of the Eligible Beneficiaries, in such equal or unequal shares and to the exclusion of any one or more of the other Eligible Beneficiaries, as the Independent Trustee shall, at any time or from time to time in the absolute discretion of the Independent Trustee, determine for any purpose.

Article I(3) provides that the trustees shall pay so much, if any, of the principal of such trust to or for the benefit of any one or more charitable organizations, and in such equal or unequal shares, as Settlor shall, at any time or from time to time by written instrument, direct and appoint; provided, however, that this power of appointment shall be a limited power, which shall not be exercisable to any extent in favor of Settlor, Settlor’s estate, the creditors of Settlor, or the creditors of Settlor’s estate (Settlor’s Inter Vivos Limited Power of Appointment).

Any net income not so paid pursuant to Article I shall be accumulated and added to principal.

Article II provides that following Settlor’s death, the trustees shall distribute the trust estate to one or more charitable organizations, and in such equal or unequal shares, as Settlor shall direct and appoint; provided, however, that this power of appointment shall be a limited power, which shall not be exercisable to any extent in favor of Settlor, Settlor’s estate, creditors of Settlor, or creditors of Settlor’s estate (Settlor’s Testamentary Limited Power of Appointment). To the extent Trust property is not effectively appointed, the trustees shall distribute such whole or part to such one or more charitable organizations, and in such equal or unequal shares, as the Independent Trustee shall determine in the absolute discretion of the Independent Trustee.

Article III(A) provides that during the life of Settlor, the Distribution Committee shall have the power to direct the trustees as provided in Article I. Following Settlor’s death, the PLR-113144-18 3 Distribution Committee shall cease to exist and the person or persons who shall, immediately prior to the death of Settlor, be in office as members of the Distribution Committee shall cease to have any authority, either individually or collectively, to direct the trustees or to exercise any other right or power under Trust.

Under Article III(B), the initial members of the Distribution Committee are Independent Trustee, Individual A and Individual B. Article III(C) provides that Settlor, or if Settlor at any time is not able to act, the members of the Distribution Committee may appoint successor members to the committee. The Independent Trust also has the power under Article III(D) to appoint members to the committee.

Article III(F) provides that (i) there shall be at least one member of the Distribution Committee in office at all times during Settlor’s life and (ii) a majority of the members of the committee shall, at all times during Settlor’s life, consist of Eligible Beneficiaries.

Article III(G) provides that if and so long as there shall be more than one member on the Distribution Committee, the committee shall act by majority vote of such members.

Article V(G) provides that there shall not be more than three individuals, or more than two individuals and one corporation in office as trustees of Trust, and none of Settlor, Settlor’s husband, and any individual or corporation who is related or subordinate to Settlor or Settlor’s husband (within the meaning of § 672(c)) is eligible to serve as trustee of Trust.

Article XII(B)(6) defines the term “charitable organization” to mean and include only an organization (a) that is described in §§ 170(c), 2055(a), and 2522(a); and (b) that shall not, by any action or course of conduct, have so disqualified itself that any charitable deduction that would otherwise be available for federal income, estate or gift tax purposes, in respect of property passing to such organization, would be disallowed.

Settlor has made the following representations. Settlor has not claimed nor will she claim an income tax or gift tax charitable deduction under § 170(c) or 2522(a) for any property transferred by Settlor to Trust at any time, unless and until Trust makes a payment to one or more charitable organizations. No person (including any corporation or trust) other than Settlor is presently expected to make any transfer of property to Trust at any time, so no other charitable deduction will be claimed or available for contributions of property to Trust. Trust will not set aside any amounts for charitable purposes and claim a deduction under § 642(c)(2).

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

The basic purpose of § 4947 is to prevent these trusts from being used to avoid the requirements and restrictions applicable to private foundations. For purposes of this section, a trust shall be presumed (in the absence of proof to the contrary) to have amounts in trust for which a charitable deduction was allowed if a deduction would have been allowable under one of these sections.

Section 53.4947-1(c)(1)(i) provides that a trust is one which has amounts in trust for which a deduction was allowed under § 642(c) within the meaning of § 4947(a)(2) once a deduction is allowed under § 642(c) to the trust for any amount permanently set aside.

In Virginian Hotel Corp. v. Helvering, 319 U.S. 523 (1943), the Supreme Court held that “allowed” meant that the taxpayer had taken the deduction and the Commissioner had not challenged it. Id. at 527. Noting that there was “no machinery for formal allowances of deductions from gross income,” a deduction being claimed and going unchallenged is the only way in which a deduction could be “allowed.”

Trust has both charitable and non-charitable beneficiaries and is not exempt from tax under § 501(a). One of the requirements to qualify as a split-interest trust described in § 4947(a)(2) is that the trust has amounts in trust for which a charitable deduction was allowed to some person (including the trust itself for a charitable set-aside). Settlor has represented that, for the duration of Trust, Trust will not hold any amounts for which a person claimed a charitable deduction for a transfer to Trust, or for which Trust claimed a charitable deduction under § 642(c)(2) for a set-aside. Thus, for Settlor’s life, Trust will not qualify as a split-interest trust under § 4947(a)(2). The fact that Settlor may claim a gift tax deduction under § 2522 (or that Trust may claim an income tax deduction under § 642(c)(1) when a charitable distribution from Trust is made is not material, because such amount is not held in Trust when the charitable deduction arises.

Based upon the facts submitted and representations made, we conclude that Settlor will not be a disqualified person with respect to Trust because Trust will not be treated as a split-interest trust within the meaning of §§ 4947(a)(2) and 53.4947-1(c)(1)(i) and, accordingly, the provisions of §§ 507, 508(e), 4941, 4943, 4944, and 4945 shall not apply to Trust during Settlor’s life.

In PLR 202017018 – the only ING ruling issued in 2020 – a settlor established an irrevocable trust to benefit himself, his spouse, his descendants, his parents and his parents’ descendants (in addition to himself and his own descendants). A corporate fiduciary was the sole Trustee and there was a distribution committee consisting of at least two individuals other than the settlor and the settlor’s spouse but could also include the settlor. The distribution committee was initially the settlor, the settlor’s parents and the settlor’s sister. An elaborate mechanism was set forth in the trust instrument to ensure that, throughout the settlor’s life, the distribution committee remained intact. At the settlor’s death, the distribution committee was to cease operations, and all powers previously held by the distribution committee were thereafter to be held and exercised by the Trustee. Distributions from the trust could be made as follows:

* Income or principal could be distributed to or for any beneficiary (other than the settlor’s spouse) as determined by a majority of the distribution committee, other than the settlor or the settlor’s spouse, acting in a non-fiduciary capacity, with the written consent of the settlor;
* Income or principal could be distributed to or for any beneficiary as determined unanimously by the distribution committee, other than the settlor or the settlor’s spouse, acting in a non-fiduciary capacity; and
* Principal could be distributed to or for any beneficiary (other than the settlor or the settlor’s spouse) as determined by the settlor, acting in a non-fiduciary capacity, for the health, education or support of any one or more of such beneficiaries.

Consistent with the above rules, distributions could be made in equal or unequal amounts among concurrent beneficiaries. During the settlor’s life, the Trustee was not permitted to make any distributions except as directed in accordance with the above rules. In addition, the settlor held a testamentary power of appointment that could be exercised in favor the settlors’ parents’ descendants (except the settlor, his estate, his creditors or his estate’s creditors), the settlor’s spouse or any one or more charitable organizations.

The IRS ruled as follows:

* Neither the settlor nor any member of the distribution committee will be considered the grantor or owner of the trust for income tax purposes;
* The settlor’s transfer of property to the trust will be considered not to be a completed gift for gift tax purposes;
* Discretionary distributions won’t be considered gifts for gift tax purposes by any distribution committee member; and
* A distribution committee member’s gross estate for estate tax purposes won’t include the value of any trust property.

Last year, the IRS indicated it wouldn’t issue ING trust rulings with respect to ING trusts with somewhat narrow characteristics in Revenue Procedure 2020-3. Even more recently, the IRS completely put the brakes on all ING trust rulings in Rev. Proc. 2021-3 (Section 5.01(9) & (17)). Quite obviously, for an ING trust to be effective the state in which the trust is resident must either not have an income tax or must have an income tax rate much lower than the rate being avoided.

# **SECTION 1361 – S CORPORATIONS**

# SECTIONS 2031 and 2512 – VALUATION

## **Valuation of LLCs**

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

When a gift of property is made, its value at the date of the gift shall be considered the amount of the gift. Sec. 25.2512-1, Gift Tax Regs. We do not engage in imaginary scenarios as to who a purchaser might be. Estate of Giustina v. Commissioner, 586 F. App’x 417, 418 (9th Cir. 2014), rev’g and remanding T.C. Memo. 2011-141. In Olson v. United States, 292 U.S. 246, 257 (1934), the Supreme Court explained:

Elements affecting value that depend upon events or combinations of occurrences which, while within the realm of possibility, are not fairly shown to be reasonably probable should be excluded from consideration for that would be to allow mere speculation and conjecture to become a guide for the ascertainment of value--a thing to be condemned in business transactions as well as in judicial ascertainment of truth. \* \* \*

Respondent’s expert relies upon an additional action, the purchase of the class A units. Mr. Mitchell contends that the economic realities have to be taken into consideration and that the economic stake of the holder of a 99.8% interest of the class B units “dwarfs” that of the holder of the class A units. However, Margaret, the sole owner of the class A units, testified that she had no intention of selling the units. She further testified that if she ever sold the units she would demand a premium much higher than what was estimated in the Mitchell reports. If the class B units were ever sold outside the family, Margaret explained that she would require that she be paid a management fee.

We are looking at the value of the class B units on the date of the gifts and not the value of the class B units on the basis of subsequent events that, while within the realm of possibilities, are not reasonably probable, nor the value of the class A units. See id. In Succession of McCord v. Commissioner, 461 F.3d 614, 629 (5th Cir. 2006), rev’g and remanding McCord v. Commissioner, 120 T.C. 358 (2003), the Court of Appeals for the Fifth Circuit reasoned that there are three types of conditions along the “speculative” continuum: (1) a future event that is absolutely certain to occur; (2) a future event “that is not absolutely certain to occur, but nevertheless may be a ‘more . . . certain prophec[y]’”; and (3) “a possible, but low-odds, future event” which is “undeniably a ‘less . . . certain prophec[y]’”.

Mr. Mitchell’s valuations relied on an additional action. He concluded that to determine the value of what a willing buyer would pay and what a willing seller would seek for the class B units, a premium to purchase the class A units has to be taken into account. Elements affecting the value that depend upon events within the realm of possibility should not be considered if the events are not shown to be reasonably probable. Olson, 292 U.S. at 257. The facts do not show that it is reasonably probable that a willing seller or a willing buyer of the class B units would also buy the class A units and that the class A units would be available to purchase. To determine the fair market values of the class B units we look at the willing buyer and willing seller of the class B units, and not the willing buyer and willing seller of the class A units.

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

## **Valuation of LLCs Holding Leased Property For Gift, Estate, and Charitable Purposes**

. Judge Buch has decided for the Tax Court a straightforward valuation case in Estate of Warne v. Commissioner, T.C. Memo. 2021-17. There were five LLCs at issue with various percentages owned by a family trust included in the decedent’s estate.

The easiest issue for the court to deal with was the estate tax charitable deduction. At the decedent’s death she left 75% of Royal Gardens, LLC to the family foundation and 25% to St. John’s Lutheran Church. The estate argued that 100% went to charity but the IRS argued Ahmanson Foundation v. United States, (9th Cir. 1981) and the Tax Court agreed with the IRS. An estate receives a charitable deduction only for what charities receive, which the court held was a 4% discount for the 75% and a 27.385% discount for the 25% (each stipulated by the parties). The discounts could have been avoided by leaving 100% to the Foundation and having it distribute 25% to the church.

The family trust held fractions of the other LLCs as follows:

At the time of Miriam Warne’s death, the LLCs had the following ownership structure: WRW was held 78% by the Family Trust and 22% by William Warne; VJK was held 86.3% by the Family Trust, 0.5% by Tom Warne, and 4.4% by each of the three granddaughters; Warne Ranch was held 72.5% by the Family Trust, 26% by Tom Warne, and 0.5% by each granddaughter; Warne Investments was held 87.432% by the Family Trust and 12.568% by Trust “H”; and Royal Gardens was held 100% by the Family Trust. William Warne and Tom Warne were cotrustees of the Family Trust. They are also coexecutors of Miriam Warne’s estate.

The experts valued the leased real estate using a sales comparison approach to value the land. With respect to the effect of discounts at the entity level, the opinion states:

The discount for lack of control for the majority interests held by the Family Trust should be low. The LLCs’ operating agreements grant significant power to the majority interest holder, such as the ability to unilaterally dissolve the LLCs and appoint and remove managers. The Family Trust held the majority interest in every LLC at issue. When a majority interest holder exerts control similar to that which the Family Trust can exercise in the LLCs, we have held that no discount for lack of control applies.31 Because the parties agree to a discount for lack of control, we will find one; however, given the control retained by the Family Trust, the discount should be slight.

The IRS’s expert argued for a 2% lack of control discount based on closed-end mutual funds, which the court rejected. The taxpayer’s expert argued based on data from minority interest sales for a 5% - 8% discount. However the taxpayer’s expert also assumed that if the majority tried to liquidate the minority would sue which the court concluded was an unwarranted assumption. So the court applied a 4% lack of control discount. The court much preferred the taxpayer’s expert on lack of marketability, stating:

The parties’ experts used the same general method to calculate their discounts for lack of marketability. Both experts calculated the LLCs’ restricted stock equivalent discounts and adjusted that calculation to account for the LLCs’ characteristics to reach the final discount for lack of marketability. However, Mr. Schwab’s analysis was more credible. His report considered additional metrics and provided a more thorough explanation of his process. In calculating the restricted stock equivalent discount, he determined the most important factors-- such as the market-to-book ratio and market risk volatility--and he gave them more significant weight in his analysis. Mr. Schwab concluded a 10% to 12% restricted stock equivalent discount and decreased it by 25% as a holding period adjustment. He opined that a 5% to 10% discount for lack of marketability should apply.

In contrast, Mr. Robak concluded a 2% discount for lack of marketability, providing little information to support this conclusion. In calculating the restricted stock equivalent discount, Mr. Robak weighted every factor equally and reached a 14.5% restricted stock equivalent discount. He then calculated a 2% discount for lack of marketability without justifying the substantial decrease in the discount. When an expert does not provide enough evidence to support his opinion, we decline to adopt that opinion. Without justification for his conclusion, it appears Mr. Robak made a visceral reduction of the discount rate data instead of a statistical one. We therefore decline to adopt the Commissioner’s discount for lack of marketability analysis.

We adopt Mr. Schwab’s lack of marketability discount but believe it should remain at the lower end of the 5% to 10% range. Therefore, the discount for lack of marketability for the LLCs is 5%.

Each of the parties used different experts to value the underlying properties then the entities.

The taxpayers had not filed a timely gift tax return and the court upheld a penalty because the estate presented no evidence of reasonable cause.

## **Valuation of Image and Likeness**

. The Tax Court was presented with valuing the decedent’s image and likeness, as well as certain business assets, in Estate of Michael Jackson, T. C. Memo. 2021-48. Judge Holmes wrote a lengthy opinion (breezy, for a Tax Court judge) which reviews much of Jackson’s business and musical career (omitting discussion of personal matters almost entirely) and also outlines the current business strategies of the music industry. With respect to valuation itself the most broadly applicable points are that the court refused to tax effect streams of earnings and refused to apply a penalty to the estate. Regarding the tax effecting issue, the opinion states:

Fishman, Wallis, and Dahl in their respective DCF analyses concluded that the appropriate hypothetical buyer for each asset would be a C corporation, and therefore, each of them reduced cashflows by the income-tax liability that would be paid by a hypothetical C corporation buyer. To make things even more complicated, each also computed a discount rate that included the effects of a C corporation's tax rate. They all stated that this was appropriate because it used both after-tax cashflows and after-tax discount rates. Each of the Estate's experts, however, used a different tax rate to do his computation:

• Fishman applied a 35% rate based on the federal rate,

• Wallis applied a 39.615% rate based on a combined federal and New York State rate, and

• Dahl applied a 39.8% rate based on a combined federal and undisclosed state rate.

When we've faced this issue in the past, we've shied away from tax affecting because of these difficult practical problems. See Estate of Gallagher, 101 T.C.M. (CCH) at 1710; Estate of Giustina, 101 T.C.M. (CCH) at 1679; Dallas v. Commissioner, 92 T.C.M. (CCH) 313, 317-18 (2006) (tax affecting not appropriate when the taxpayer presumed that an S corporation would lose its S corporation status after a sale); Gross, 78 T.C.M. (CCH) at 207. For example, in Wall v. Commissioner, 81 T.C.M. (CCH) 1425, 1432-33 n.19 (2001), we noted that

[t]he argument in favor of tax-effecting stresses that many potential buyers of S corporations are C corporations. Because a C corporation would be unable to maintain a target company's S corporation status following an acquisition, the C corporation would tax-effect the S corporation's income (at C corporation rates) in deciding how much it would pay for the S corporation. See Trugman, Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Businesses, at 198-199 (1998). By contrast, the argument against tax-effecting stresses that although an S corporation's stockholders are subject to tax on the corporation's income, they are generally not subject to a second level of tax when that income is distributed to them. This could make an S corporation at least somewhat more valuable than an equivalent C corporation. However, tax-effecting an S corporation's income, and then determining the value of that income by reference to the rates of return on taxable investments, means that an appraisal will give no value to S corporation status.

There has, it seems, been only one case where we allowed tax affecting in a valuation. See Estate of Jones v. Commissioner, T.C. Memo. 2019-101, at \*41-\*42. In Estate of Jones, both experts agreed that a hypothetical buyer and seller would take into account the form of business entity in determining the fair market value of a limited-partnership interest. Id. at \*39. The parties just disagreed on how to account for this effect. Id. The Commissioner's expert argued against tax affecting because the company at issue was a natural-resource holding company--not because it would pay no entity-level tax. Id.

The experts here strongly disagree on the appropriateness of tax affecting. We view this disagreement just as we have in the past, as one that is a dispute about fact. And we find, as we have done consistently in the past apart from Estate of Jones, that by a preponderance of the evidence tax affecting is not appropriate here because the Estate has failed to persuade us that a C corporation would be the hypothetical buyer of any of the three contested assets. The Estate's experts did not even discuss in a persuasive way their reasons for assuming that a C corporation would be the only or even likely buyer for these assets.

\* \* \*

Our finding reflects these facts: The Estate's own experts used inconsistent tax rates. They failed to explain persuasively the assumption that a C corporation would be the buyer of the assets at issue. They failed to persuasively explain why many of the new pass-through entities that have arisen recently wouldn't be suitable purchasers. And they were met with expert testimony from the Commissioner's side that was, at least on this very particular point, persuasive in light of our precedent. This all leads us to find that tax affecting is inappropriate on the specific facts of this case. We distinguish Estate of Jones as an instance where the experts agreed to take into account the form of the business entity and agreed on the entity type. The Commissioner argued there, as he does here, that we shouldn't tax affect, but his own experts didn't seem to be on board. As we observed, “[t]hey do not offer any defense of respondent's proposed zero tax rate. Thus, we do not have a fight between valuation experts but a fight between lawyers.” Estate of Jones, at \*39.

We do not hold that tax affecting is never called for. But our cases show how difficult a factual issue it is to demonstrate even a reasonable approximation of what that effect would be. In Estate of Jones, there was expert evidence on only one side of the question, and that made a difference.

That was not the case here.

The IRS and estate values were significantly far apart on values as noted in the Conclusion to the opinion:

|  |  |  |  |
| --- | --- | --- | --- |
| Asset | Estate | Commissioner | Tax Court |
| Jackson's image and likeness | $3,078,000 | $161,307,045 | $4,153,912 |
| NHT II | -0- | 206,295,934 | -0- |
| NHT III | 2,267,316 | 114,263,615 | 107,313,561 |

But no penalties were imposed:

The Estate valued Jackson's image and likeness at roughly $2,000 on its return. This was based on an appraisal by Moss Adams--an accounting firm that we specifically find is reputable and credible. See supra pp. 49, 100-01. Moss Adams based its valuation on the last 10 years of Jackson's life, and concluded to the surprise of the Estate that Jackson's image and likeness was not worth very much. The Commissioner argues that this valuation was clearly wrong--and the Estate should have known not to rely on it.

But the facts show that this low valuation wasn't that farfetched. Jackson made almost no money attributable to his name and likeness in the last decade of his life, especially after the 2003 trial. And in 2009, even as Jackson rapidly sold out multiple concerts, exploitation of his name and likeness earned him only $24. Moss Adams followed standard appraisal procedure in this area--it focused on the last 10 years of Jackson's life. Though Fishman and Roesler--who we find credible--eventually expanded their dataset, they both stated in their reports that they typically only look at the 10 most recent years of income. While we disagree with Moss Adams's appraisal, we do find that it was reasonable. And we find that the Estate reasonably relied on it in good faith once it discovered how little revenue Jackson had been earning from use of his name and likeness. No penalties here.

We find much the same for the valuation of NHT III. Our own opinion shows how complicated valuing Mijac and NHT III is. The Estate again used Moss Adams to help them estimate this value. We also disagree with this appraisal value, but we again find that it was reasonable given all the facts and circumstances. And we again find it was reasonable for the Estate to rely on it and that it did so in good faith. No penalties here either.

The estate had multiple experts, whereas the IRS only had one. The court was not thrilled with the IRS expert:

As the Commissioner's only expert witness, Anson's credibility was an especially important part of the case. And it suffered greatly at trial. His problems began when he was asked about the effect on himself and his firm if the Commissioner prevailed in the case. He responded: “I have no idea. I've never worked for the Internal Revenue Service before.” Later when asked whether he or his firm had previously been retained by the Commissioner to write an intellectual-property valuation report in Whitney Houston's estate-tax case, Anson replied: “No. Absolutely not.” That was a lie. Approximately two years before he testified, the Commissioner had retained Anson to write a valuation report titled, “Analysis of the Fair Market Value of the Intangible Property Rights Held by the Estate of Whitney E. Houston as of February 11, 2012 For Estate Tax Purposes.” It was only after a recess and advice from the Commissioner's counsel that Anson admitted to this.

Anson also testified that neither he nor his firm ever advertised to promote business. This was also a lie. In the midst of trial, Anson's firm touted his testimony in the following email blast:

What has been described as the “tax trial of the century” by the Hollywood Reporter, the case between the Internal Revenue Service and the Estate of Michael Jackson began in Tax Court this week. CONSOR Chairman Weston Anson is the expert of the century and will be testifying on behalf of the IRS.

The big discrepancy in the value of the Jackson estate will be sure to bring testimony tailor made for a Hollywood blockbuster. While CONSOR valued the intellectual property assets of the Jackson estate at a total close to $1 billion, the estate initially valued the assets at time of death at a mere $2,105.

And in a lecture given before trial Anson referred to his valuation in this case, stating, “I'm sitting today \* \* \* in a deposition in what's known as the ‘Billion Dollar Tax Case.’ \* \* \* [W]e've just spent the last year valuing the estate of Michael Jackson.” When asked at trial whether he had in fact referred to this case as a billion-dollar case, Anson replied with his own question: “Would you like to be called the lawyer of the century?”

The Estate moved to strike all of Anson's testimony, including his expert reports, as tainted by perjury. We denied the Estate's motion finding it “too severe.” We instead stated that “[a] more proportionate remedy would be to discount the credibility and weight we give to [Anson's] opinions.” There is nothing wrong about marketing one's services or taking on another case for the IRS while working on this one. But Anson did undermine his own credibility in being so parsimonious with the truth about these things he didn't even benefit **[\*61]** from being untruthful about, as well as in not answering questions directly throughout his testimony.

This affects our factfinding throughout.

# SECTION 2032 — ALTERNATE VALUATION AND SECTION 2032A — SPECIAL USE VALUATION

## New Proposed Alternate Valuation Regulations

. [WAITING ON FINAL REGULATIONS.] REG-112196-07. An estate may elect alternate valuation and value its assets as of six months after death for estate tax purposes. If the alternate valuation date is elected, property disposed of before six months after death is valued on the date of the disposition. §2032 was originally enacted in 1935, after the stock market crash of 1929. On April 25, 2008, Treasury issued proposed Regulations to restrict the application of section 2032 by preventing post-death events other than market conditions from being taken into account when valuing the property. Those Proposed Regulations defined market conditions as events outside the control of the decedent, the decedent's executor or trustee, or any other person whose property being valued affected the fair market value of the property. The government’s defeat in Kohler v. Commissioner, T.C. Memo. 2006-152, inspired the Proposed Regulations. The Tax Court ruled in Kohler that stock received by an estate in a post-death reorganization should be the property valued on the alternate valuation date and that the restrictions placed on the stock should be taken into account.

In its action on decision stating non-acquiescence, the IRS took the view that the court incorrectly applied the regulations by allowing a post-death change in the character of the property to be taken into account when determining the property's value. The IRS thought that the court misapplied Treas. Reg. § 20.2032-1(c)(1), which provides that a tax-free reorganization is not a disposition under section 2032.

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

Generally, paragraph (c)(1)(i) identifies transactions that constitute distributions, sales, exchanges, or dispositions of property. If an estate's (or other holder's) property is subject to such a transaction during the alternate valuation period, the estate must value that property on the transaction date. The value included in the gross estate is the fair market value of that property on the date of and immediately prior to the transaction. The term "property" refers to the property includible in the decedent's gross estate under section 2033.

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

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

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

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

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

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

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

(ii) If, instead, the difference between the two fair market values as of the date of the reorganization was equal to or less than 5% of the fair market value, as of the date of the reorganization, of the stock D held at death, the reorganization would satisfy the exception provided in paragraph (c)(1)(ii) of this section. Thus, the alternate valuation date would be the 6-month date. The value to be included in D's gross estate would be the fair market value, determined as of the 6-month date, of the new class of stock in Y that D's estate received in the reorganization.

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

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

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

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

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

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

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

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

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

# SECTION 2033 – GROSS ESTATE

# SECTIONS 2035-2038 – RETAINED INTERESTS

## **Tax Court Strikes A Blow Against Discount Planning**

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

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

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

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

(a) General Rule.—The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), \* \* \* under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death—

(1) the possession or enjoyment of, or the right to the income from, the property, or

(2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

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

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

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

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

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

The Court correctly concludes that section 2036(a)(2) applies here. See op. Ct. pp. 14–21 (relying on Estate of Strangi v. Commissioner, T.C. Memo. 2003–145, 85 T.C.M. (CCH) 1331, aff'd on other grounds, 417 F.3d 468 (5th Cir. 2005)). The decedent clearly “made a transfer” of the $10 million in cash and securities. And she clearly retained the proverbial “string” that pulls these assets back into her estate.

But the Court concludes, see op. Ct. p. 22, that section 2036(a) does not require “the inclusion in the value of decedent's gross estate of the full date-of-death value of the cash and securities,” while admitting that the statute, “read in isolation, would require that result.” See Estate of Thompson v. Commissioner, T.C. Memo. 2002–246, 84 T.C.M. (CCH) 374, 386 (“Section 2036(a) effectively includes in the gross estate the full fair market value \* \* \* of all property transferred in which the decedent had retained an interest.” (Emphasis added.)). Instead, the Court holds that [section 2036(a)(2)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1012823&cite=26USCAS2036&originatingDoc=Ie16d19d03d6e11e799c1e9209d7cf8d2&refType=SP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_d86d0000be040) brings into the gross estate a much smaller sum: the value of the cash and securities ($10 million) minus the value of the limited partnership interest that the decedent got in exchange. Otherwise, the Court says, the $10 million would be included in her estate twice: first via section 2036(a)(2) and again via her partnership interest, which would be separately includible as property of the estate under section 2033.

This is where I part company with the Court, because I do not see any “double inclusion” problem. The decedent's supposed partnership interest obviously had no value apart from the cash and securities that she allegedly contributed to the partnership. The partnership was an empty box into which the $10 million was notionally placed. Once that $10 million is included in her gross estate under section 2036(a)(2), it seems perfectly reasonable to regard the partnership interest as having no distinct value because it was an alter ego for the $10 million of cash and securities.

This is the approach that we have previously taken to this problem. See Estate of Thompson, 84 T.C.M. (CCH) at 391 (concluding that the decedent's interest in the partnership had no value apart from the assets he contributed to the partnership); Estate of Harper v. Commissioner, T.C. Memo. 2002–121, 83 T.C.M. (CCH) 1641, 1654; cf. Estate of Gregory v. Commissioner, 39 T.C. 1012, 1020 (1963) (holding that a decedent's retained interest in her own property cannot constitute consideration under section 2043(a)). And this is the approach that I would take here. There is no double-counting problem if we read section 2036(a)(2), as it always has been read, to disregard a “transfer with a string” and include in the decedent's estate what she held before the purported transfer—the $10 million in cash and securities.

Rather than take this straightforward path to the correct result, the Court ad-opts as the linchpin of its analysis section 2043(a). Neither party in this case advanced any argument based on section 2043(a); indeed, that section is not cited in either party's briefs. And as the Court recognizes, see op. Ct. p. 28, we have not previously applied section 2043(a), as the Court does here, to limit the amount includible in a decedent's gross estate under section 2036(a). See, e.g., Estate of Harper, 83 T.C.M. (CCH) at 1654 (ruling that section 2043(a) “is inapplicable where, as here, there has been only a recycling of value and not a transfer for consideration”).

Invoking section 2043(a), the Court divides the $10 million into a “doughnut” and a “doughnut hole.” The “doughnut” consists of the limited partnership interest allegedly received by the decedent; on the Court's theory, this is pulled back into the gross estate via section 2035 or 2038, and its value then included under section 2033. As a result, section 2036(a), paired with section 2043(a), has the much-reduced function of bringing back into the gross estate, not the full value of the $10 million as that section by its terms requires, but only “the amount of any discounts (that is, the doughnut holes) allowed in valuing the partnership interest.” See op. Ct. pp. 26–27. This theory seemingly validates the estate's claimed discount for lack of marketability, which seems highly suspect on the facts presented.

The Court's exploration of section 2043(a) seems to me a solution in search of a problem. It is not necessary; the parties did not think it was necessary; and our prior cases show that it is unnecessary. And even if the section 2043(a) issue were properly presented, I am not sure that the Court's application of that provision is correct. It is far from clear to me that the decedent's partnership interest—a consequence of the now-disregarded transfer—can constitute “consideration in money or money's worth” within the meaning of section 2043(a).

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

Another approach is to sell the decedent’s interest in the entity. The issue there is whether if the sale is for less than would be included in the decedent/seller’s estate did the decedent/seller receive full consideration. In United States v. Allen, 293 F.2d 916 (10th Cir. 1961) the decedent created a trust reserving 3/5ths of the income for life; many years later she sold the income interest for far less than the value of 3/5ths of the trust. The court held that was an inappropriate loophole because – under the 1939 Code – a taxpayer could keep income for most of the taxpayer’s life and then sell close to death for a fraction of what otherwise would be included.

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

The parties disagree as to the type of interest that must be valued and included in the value of decedent’s gross estate. [footnote omitted]

The estate contends that the agreement created an assignee interest in decedent’s limited partnership interest under Texas State law and the partnership agreement. It contends that it valued and reported decedent’s interest in the revocable trust correctly as an assignee interest on Schedule G of its tax return. Respondent contends that the agreement did not create an assignee interest held by the revocable trust. Respondent argues that decedent transferred his 88.99% limited partnership interest to the revocable trust and the value to be included in the value of the gross estate should be that of a limited partnership interest.

We need to determine whether the interest decedent transferred to the revocable trust was a limited partnership interest or an assignee interest. Generally, State law determines the property interest that has been transferred for Federal estate tax purposes. See McCord v. Commissioner, 120 T.C. 358, 370 (2003), rev’d and remanded on other grounds, 461 F.3d 614 (5th Cir. 2006). TRLPA (as in effect for the relevant period) provides that a partnership interest is personal property and is assignable, in whole or in part, unless the partnership agreement provides otherwise. Tex. Rev. Civ. Stat. Ann. art. 6132a-1, secs. 7.01 and 7.02(a)(1) (West). An assignee of a partnership interest is entitled to receive, to the extent assigned, allocations of income, gain, loss, deduction, credit, or similar items, and to receive distributions to which the assignor is entitled, but an assignment does not entitle the assignee “to become, or to exercise rights or powers of, a partner”. Id. sec. 7.02(a)(2) and (3). The assignee may become a limited partner, with all rights and powers of a limited partner under a partnership agreement, in the manner that the partnership agreement provides or if all partners consent. Id. sec. 7.04(a) and (b).

Although we consult State law to determine what property interests were transferred, our inquiry may not end there. See McCord v. Commissioner, 120 T.C. at 371. The Federal tax effect of a particular transaction is governed by the substance of the transaction rather than its form. Frank Lyon Co. v. United States, 435 U.S. 561, 573 (1978). The doctrine that the substance of a transaction will prevail over its form has been applied in Federal estate and gift tax cases. See Heyen v. United States, 945 F.2d 359, 363 (10th Cir. 1991); Estate of Murphy v. Commissioner, T.C. Memo. 1990-472. In particular, we have indicated a willingness to look beyond the formalities of intrafamily partnership transfers to determine what, in substance, was transferred. See Kerr v. Commissioner, 113 T.C. 449, 464-468 (1999), aff’d, 292 F.3d 490 (5th Cir. 2002). We will consider both the form and the substance of decedent’s transfer to the revocable trust to determine whether the property interest transferred was an assignee interest or a limited partnership interest.

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We conclude that the form of the agreement establishes that decedent transferred to the revocable trust a limited partnership interest and not an assignee interest. The economic realities underlying the transfer of decedent’s interest also support our conclusion that the transferred interest should be treated as a limited partnership interest for Federal estate tax purposes. This is because we conclude that regardless of whether an assignee or a limited partnership interest had been transferred, there would have been no substantial difference before and after the transfer to the revocable trust. See Kerr v. Commissioner, 113 T.C. at 467-468. Pursuant to Streightoff Investments’ partnership agreement only the general partner had the right to direct the partnership’s business; neither limited partners

nor assignees had managerial rights. The partnership agreement provided that assignees had no rights to any information regarding the business of the partnership or to inspection of the books or records of the partnership. However, this distinction made no difference in this case because Ms. Streightoff was both a partner entitled to information regarding Streightoff Investments and the trustee of the revocable trust.

The partnership agreement provided that an “unadmitted assignee” did not have the right to vote as a limited partner. In Kerr v. Commissioner, 113 T.C. at 467, we determined that the only real difference between the rights of a limited partner and those of an assignee was the right to vote on partnership matters, and we concluded that this difference was not significant. We held that under such circumstances the transferred interest should be valued as a limited partnership interest rather than as an assignee interest. Id. Here, we conclude similarly that whether the revocable trust held the voting rights associated with a limited partnership interest would have been of no practical significance. There were no votes by limited partners following the execution of the agreement. Additionally, during his life decedent held the power to revoke the transfer to the revocable trust. If he had revoked the transfer, he would have held all the rights of a limited partner in Streightoff Investments, including the right to vote on partnership matters. Also, Streightoff Management as the general partner could have treated the holder of an assignee interest as a substitute limited partner. Under the facts and circumstances of this case, there was no difference in substance between the transfer of a limited partnership interest in Streightoff Investments and the transfer of an assignee interest in that limited partnership interest. See id.; Astleford v. Commissioner, T.C. Memo. 2008-128, slip op. at 16. Accordingly, as a matter of both form and substance, the interest to be valued for estate tax purposes is an 88.99% limited partnership interest in Streightoff Investments.

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

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

## **Application of Section 2043 to Defective FLP Transfer**

. The 30,000 foot view of Moore v. Commissioner, T.C. Memo. 2020-40, is set out by Judge Holmes of the Tax Court as follows:

Howard Moore was born into rural poverty but over a long life built a thriving and very lucrative farm in Arizona. In September 2004 he began negotiating its sale, but his health went bad. He was released from the hospital and entered hospice care by the end of that year.

Then he began to plan his estate.

What his lawyer came up with was quite complex--a combination of five trusts and a partnership--and it required him to contribute most of his farm to the partnership. His stated reason was to protect the farm from various business risks and bring his sometimes fractious family together to learn to manage the business without him. But five days after the partnership received part ownership of the farm, Moore sold it. And even after the sale, Moore stayed on the farm and directed its operations until he died.

The key question we have to answer is whether Moore’s plan works to reduce the size of his taxable estate. We also have to figure out whether Moore’s efforts to reduce the size of his taxable estate resulted in taxable gifts.

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

a. The Problem of Section 2043(a)

The root of this problem is that section 2043 prohibits the Commissioner from just adding the proceeds from the sale of Moore’s farm to his gross estate. It requires instead a more complicated set of calculations when there are transactions--like the transfer of four-fifths of the farm from the Living Trust to the FLP--that fall within section 2036. Section 2043(a) says (with the key word italicized)

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

The number that needs to be included in the gross estate can be expressed in an equation: Vincluded = Cd + FMVd - Ct, where

Vincluded = value that must be added to the gross estate;

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

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

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

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

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

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

Let’s turn to those.

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

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

And now we can introduce discounted FLP interests.

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

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

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

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

ii. Application of Section 2043(a)

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

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

Ct. Section 2043 tells us to subtract from this value of the farm the value of the consideration that Moore received. We value this consideration on the date it was received. One-fifth of the value of the farm went directly to the Living Trust and is a matter of multiplication. But what of the remaining four-fifths? This is the portion that went from the Living Trust to the FLP in exchange for an interest in the FLP. Here the parties’ estimations diverge. The estate says that Moore got an interest in the FLP worth about $5.3 million; the Commissioner argues that it was worth about $8.5 million. Because of the brief time between the challenged transfer and Moore’s death, we find it more likely than not that this value--whether it was $5.3 million or $8.5 million--did not change between the time Moore received it and the time he died. On the facts of these cases, then, we don’t think this dispute matters because we would add back either figure after subtracting it.

With the value of the consideration that Moore received measured at the time he received it equal to the value of the consideration that remained in his estate at the time of his death, the equation thus far is:

(Either $5.3 million or $8.5 million + (.2 \* value of farm at date of death)) + ((value of farm at date of death) - ((either $5.3 million or $8.5 million) + (.2 \* value of farm at date of death))).

Cd. This variable, however, is not simply the value of the consideration from the challenged transaction. Section 2033 tells us to include only the value of that consideration that remains in the estate as of the date of Moore’s death. To get to this number we have to look for any money that left that estate after the farm’s sale and before that date. There were three of these adjustments to the Cd variable that the parties identified and argued about:

• unpaid attorney’s fees,

• transfers to Moore’s children, and

• $2 million dollar purported loan.

The court concluded the transfers and loans were gifts.

The upshot of the section 2043 analysis is that taxpayers need to avoid section 2036 if at all possible. Disposition of all interests in entities three years prior to death is helpful, as could be use of an incomplete gift trust to facilitate the gift or sale of non-voting units. If assets appreciate between the time of transfer and the time of inclusion there may be double inclusion. Alternatively, before death the transaction needs to be unwound with some assets “in” and others “out” of the soon-to-be decedent’s estate.

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

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

The denominator is the value of the Living Trust as determined for federal estate-tax purposes.

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

There is also a second, much more general problem here. Charitable deductions are allowed only for the value of property in a decedent’s gross estate if transferred to a charitable donee “by the decedent during his lifetime or by will.” [Sec. 20.2055-1(a), Estate Tax Regs](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1016188&cite=26CFRS20.2055-1&originatingDoc=I1839b6f0793311ea8f44f6432bc8ecf9&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_8b3b0000958a4). We have repeatedly denied charitable deductions where the donation turned upon the actions of the decedent’s beneficiary or an estate’s executor or administrator. See, e.g., Estate of Engelman v. Commissioner, 121 T.C. 54, 70-71 (2003); Estate of Marine v. Commissioner, 97 T.C. 368, 378-79 (1991), aff’d, 990 F.2d 136 (4th Cir. 1993).

Charitable deductions must be ascertainable at a decedent’s date of death. Ithaca Tr. Co. v. United States, 279 U.S. 151, 154 (1929)(transfers to a charity must be “fixed in fact and capable of being stated in definite terms of money”); Estate of Marine, 97 T.C. at 375. Section 20.2055-2(b)(1), Estate Tax Regs., states:

If, as of the date of a decedent’s death, a transfer for charitable purposes is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that the charitable transfer will not become effective is so remote as to be negligible.

Whether the Living Trust would get additional funds from the Irrevocable Trust to transfer to the Charitable Trust was not ascertainable at Moore’s death but only after an audit by the Commissioner, followed by a determination that additional property should be included in Moore’s estate, followed by either the successful defense of that position or the estate’s acquiescence to his determinations. For the exception to apply, it would have to have been almost certain that the Commissioner would not only challenge, but also successfully challenge the value of the estate. We do not think that’s a reasonable conclusion.

The estate likens its facts to those of Estate of Christiansen v. Commissioner, 586 F.3d 1061 (8th Cir. 2009), aff’g 130 T.C. 1 (2008), and Estate of Petter v. Commissioner, 653 F.3d 1012 (9th Cir. 2011), aff’g T.C. Memo. 2009-280. In Estate of Christiansen v. Commissioner, 586 F.3d at 1062-63, even though the amount of the property to be transferred was subject to change based on a formula clause, we allowed a charitable deduction because the transfer itself was not contingent on the happening of some event.

In Estate of Petter, a FLP was to distribute LLC units to the trusts that Ms. Petter had set up for each of her children. The trusts were to receive a specific number of units up to a set dollar amount, with any units over that set value going to charity. Estate of Petter, 653 F.3d at 1020. Since the value of these units was unknown (because it was based on the FMV of stock held by the FLP), id., if a subsequent audit by the Commissioner led to a revaluation of the units then some of those units that had already been transferred to trusts had to be retransferred to the charitable donee in accordance with the trust provisions, [id. at 1019](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=2025820456&pubNum=0000506&originatingDoc=I1839b6f0793311ea8f44f6432bc8ecf9&refType=RP&fi=co_pp_sp_506_1019&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_506_1019). As in Estate of Christiansen, value was at issue, but not whether there would be a transfer to the donee at all. Estate of Petter, 653 F.3d at 1018.

Article 5, section 2 of Moore’s Irrevocable Trust does not say that the Living Trust will receive a transfer of assets of unknown value. It says that whether the Living Trust will even receive a transfer of assets is unknown-contingent on an examination by the Commissioner. This is unlike Estate of Christiansen, where we knew the charity would get a transfer of assets, just not the value, or Estate of Petter, where we knew the charity would get some transfer of value, just not how much. Here, we don’t know if the charity would get any additional assets at all.

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

# SECTIONS 2041 AND 2514 — GENERAL POWERS OF APPOINTMENT

## **Effect of Change of State Law on General Power in Trustee**

. A decedent was sole trustee and a beneficiary in PLR 202020008, with discretion to distribute assets as follows:

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

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

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

In Year 2, Decedent became a resident of State B and remained a State B resident until his death on Date 3. Statute 2, effective in State B at the time of Decedent's death, provides in part that unless the terms of the trust expressly indicate that Statute 2 does not apply, a person who is a beneficiary and a trustee may not make discretionary distributions of either principal or income to or for the benefit of that trustee, except to provide for that trustee's health, education, maintenance, or support as described under § 2041 and § 2514 of the Code.

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

In Ruling 1 of the present case, we conclude that the enactment of Statute 1 did not constitute a release of a general power of appointment by Decedent. In Ruling 2 of the present case, we conclude that Decedent did not have a general power of appointment at the time of his death and that the lapse of Decedent's fiduciary powers as trustee at his death did not constitute a release of a general power of appointment. Therefore, we conclude neither the enactment of Statute 1 nor the lapse of Decedent's fiduciary powers at his death constitute a constructive addition to the trust for purposes of § 26.2601-1(b)(1)(v)(A).

The enactment of Statute 1 did not change the standard for which distributions can be made to Decedent under the terms of Trust 1 or Trust 2. The enactment of Statute 1 changed who may exercise certain fiduciary powers. Any successor trustee or co-trustee of Trust 1 or Trust 2 appointed pursuant to Article Eighth of Mother's will or Article Ninth of Father's will would have had the power to make the broader distributions to Decedent from Trust 1 and Trust 2 as are allowable under Article Sixth of Mother's will and Article Seventh of Father's will, respectively. The state law restriction on Decedent's ability to exercise the fiduciary powers himself, as trustee of Trust 1 and Trust 2, does not change his interest in the trust for the purposes of § 26.2601-1(b)(4)(i)(D)(2).

In the present case, we conclude that the enactment of Statute 1 will not be considered a modification or trustee action that: (1) results in a shift of a beneficial interest in Trust 1 or Trust 2 to any beneficiary who occupies a generation lower than the persons holding the beneficial interests prior to the modification; or (2) extends the time for vesting of any beneficial interest in Trust 1 or Trust 2 beyond the period provided for in the original trust terms. Accordingly, we conclude that the enactment of Statute 1 did not affect the exempt status of Trust 1 or Trust 2. Additionally, we conclude that because Statute 2 imposes substantially the same changes as Statute 1, Decedent becoming a resident of State B and becoming subject to Statute 2 did not affect the exempt status of Trust 1 or Trust 2.

The ruling is one of a series.

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

## **Analysis of Split Dollar Plan**

. Estate of Clara M. Morrissette v. Commissioner, 146 T.C. 171 (2016) confronts directly the gift tax consequences of split-dollar life insurance plans. Before turning to the specific arrangement before the court, it is instructive to read the court’s understanding of split-dollar insurance and the 2003 final regulations. The opinion states:

The IRS issued final regulations in September 2003 that govern all split-dollar life insurance arrangements entered into or materially modified after September 17, 2003 (final regulations). The final regulations define a split-dollar life insurance arrangement as an arrangement between an owner and a nonowner of a life insurance contract in which: (i) either party to the arrangement pays, directly or indirectly, all or a portion of the premiums on the life insurance contract; and (ii) the party paying for the premiums is entitled to recover all or any portion of those premiums, and such recovery is to be made from, or is secured by, the proceeds of the life insurance contract. Id. para. (b)(1).

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The final regulations provide two mutually exclusive regimes for taxing split-dollar life insurance arrangements entered into (or materially modified) after September 17, 2003, either the economic benefit regime or the loan regime. Id. subpara. (3)(i); see Our Country Home Enters., Inc. v. Commissioner, 145 T.C. \_\_, \_\_ (slip op. at 29) (July 13, 2015).

The determination of which regime applies to a split-dollar life insurance arrangement depends on which party owns, or is deemed to own, the life insurance policy subject to the arrangement. Generally, the person named as the owner in the insurance contract is treated as the owner of the contract. Sec. 1.61-22(c)(1), Income Tax Regs. A nonowner is any person other than the owner who has any direct or indirect interest in the contract. Id. subpara. (2).

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As an exception to the general rule, the final regulations include a special ownership rule that provides that if the only economic benefit provided under the split-dollar life insurance arrangement to the donee is current life insurance protection, then the donor will be the deemed owner of the life insurance contract, irrespective of actual policy ownership, and the economic benefit regime will apply. Id. subpara. (1)(ii)(A)(2). If, on the other hand, the donee receives any additional economic benefit, other than current life insurance protection, then the donee will be considered the owner and the loan regime will apply. Id.

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For a split-dollar life insurance arrangement to be taxed under the economic benefit regime, the owner or deemed owner will be treated as providing an annual benefit to the nonowner in an amount equal to the value of the economic benefits provided under the arrangement, reduced by any consideration the nonowner pays for the benefits. Sec. 1.61-22(d)(1), Income Tax Regs. The value of the economic benefits provided to the nonowner for a taxable year under the arrangement is equal to the sum of (i) the cost of current life insurance protection, (ii) the amount of cash value to which the nonowner has current access during the year, and (iii) any economic benefits not otherwise described that are provided to the nonowner. Id. subpara. (2).

The cost of the current life insurance protection takes into account the life insurance premium factors that the Commissioner publishes for this purpose. See id. subpara. (3)(ii). The amount of the current life insurance protection is the death benefit of the life insurance contract (including paid-up additions) reduced by the sum of the amount payable to the owner plus the portion of the cash value taxable to (or paid for by) the nonowner. See id. subdiv. (i). The amount of the insurance policy cash value is determined disregarding surrender charges or other similar charges or reductions and including insurance policy cash value attributable to paid-up additions. See id. subpara. (4)(i).

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The final regulations provide that the nonowner has current access to any portion of the policy cash value to which the nonowner (i) has a current or future right and (ii) that currently is directly or indirectly accessible by the nonowner, inaccessible to the owner, or inaccessible to the owner's general creditors. Id. subdiv. (ii).

Here, Clara M. Morrissette established a revocable trust, the Clara M. Morrissette Trust (CMM Trust), and contributed her shares in the Interstate Group (a family corporation) to the trust. In 2006 the CMM Trust entered split-dollar insurance arrangements with three Dynasty Trusts established, one for each of her three sons. The CMM Trust contributed $29.9 million to the three trusts to purchase universal life insurance policies for the sons.

To provide the Dynasty Trusts with the resources to purchase the Interstate Group stock held by or on behalf of a decedent, each Dynasty Trust purchased two universal life insurance policies, one on the life of each other brother. On October 4, 2006, (i) the Arthur Dynasty Trust purchased two universal life insurance policies, one on the life of Donald and one on the life of Kenneth; (ii) the Donald Dynasty Trust purchased two universal life insurance policies, one on the life of Arthur and one on the life of Kenneth; and (iii) the Kenneth Dynasty Trust purchased two universal life insurance policies, one on the life of Arthur and one on the life of Donald.

The opinion described the split-dollar terms as follows:

To fund the purchase of the policies, each Dynasty Trust and the CMM Trust entered into two split-dollar life insurance arrangements (each a split-dollar life insurance arrangement, and collectively, split-dollar life insurance arrangements) on October 31, 2006, to set forth the rights of the respective parties with respect to the policies. The CMM Trust contributed (i) $9.96 million to the Arthur Dynasty Trust, (ii) $9.98 million to the Donald Dynasty Trust, and (iii) $9.96 million to the Kenneth Dynasty Trust. The Dynasty Trusts then used that money to pay a lump-sum premium on each policy to maintain that policy for the insured's projected life expectancy.

Under the split-dollar life insurance arrangements, upon the death of the insured the CMM Trust would receive a portion of the death benefit from the respective policy insuring the life of the deceased equal to the greater of (i) the cash surrender value (CSV) of that policy, or (ii) the aggregate premium payments on that policy (each a receivable, and collectively, receivables). Each Dynasty Trust would receive the balance of the death benefit under the policy it owns on the life of the deceased, which would be available to fund the purchase of the stock owned by or for the benefit of the deceased. If a split-dollar life insurance arrangement terminates for any reason during the lifetime of the insured, the CMM Trust would have the unqualified right to receive the greater of (i) the total amount of the premiums paid or (ii) the CSV of the policy, and the Dynasty Trust would not receive anything from the policy.

Each split-dollar life insurance arrangement includes the following recital: "WHEREAS, the parties intend that this Agreement be taxed under the economic benefit regime of the Split-Dollar Final Regulations, and that the only economic benefit provided to the [Dynasty] Trust[s] under this arrangement is current life insurance protection."

Additionally, the Dynasty Trusts executed collateral assignments of the policies to the CMM Trust to secure payment of the amounts owed to the CMM Trust. Neither the Dynasty Trusts nor the CMM Trust retained the right to borrow against a policy.

The court noted that the Preamble to the final regulations contained an example like this transaction:

As a threshold matter, the preamble to the final regulations includes an example that is structured identically to the split-dollar life insurance arrangements at issue. The preamble distinguishes between a donor, or the donor's estate, who is entitled to receive an amount equal to the greater of the aggregate premiums paid by the donor or the CSV of the contract and a donor, or the donor's estate, who is entitled to receive the lesser of those two values. T.D. 9092, sec. 5, Gift Tax Treatment of Split-Dollar Life Insurance Arrangements, 2003-2 C.B. 1055, 1062. In the former situation, the donor makes a gift to the donee equal to the cost of the current life insurance protection provided less any premium amount paid by the donee. Id. In the latter situation, the value of the donor's gift of economic benefits equals the cost of current life insurance protection provided, the amount of policy cash value to which the trust has current access, and the value of any other economic benefits, less the amount of premiums paid by the donee. Id. Thus, it follows that where a donor is to receive the greater of the aggregate premiums paid or the CSV of the contract, the possibility of the donee receiving an additional economic benefit is foreclosed.

We are aware that the Court has previously been unpersuaded by a preamble to regulations. See Allen v. Commissioner, 118 T.C. 1, 17 n.12 (2002) ("In addition to the obvious fact that these documents also are not items of legislative history, these documents are afforded little weight in this Court." (citing Dobin v. Commissioner, 73 T.C. 1121, 1127 n.9 (1980))). We are not bound by the preamble, but because it is an agency's interpretation of its statute, we apply the standard enunciated by the Supreme Court in Skidmore v. Swift & Co., 323 U.S. 134, 140 (1944). Therefore, the Commissioner is entitled to at least the lowest level of deference in interpreting his own regulations and their statutes. See United States v. Mead Corp., 533 U.S. 218, 221 (2001); ADVO, Inc. v. Commissioner, 141 T.C. 298, 322 (2013); Armco, Inc. v. Commissioner, 87 T.C. 865, 868 (1986) (explaining how a preamble is drafted and that it is a statement of intent that represents the institutional viewpoint). Here, however, the preamble is consistent with the estate's interpretation of the statute and contrary to respondent's position. While we find the logic of the preamble sound, to be thorough we will articulate why, under the final regulations, the economic benefit regime applies.

Here, the court found the special ownership rule would apply because the Dynasty Trusts had no access to cash value:

For the Dynasty Trusts to have current access under the final regulations, the Dynasty Trusts must first have a current or future right to any portion of the policy cash value. The split-dollar life insurance arrangements are structured so that upon the termination of a split-dollar life insurance arrangement during the lifetime of the insured, 100% of the CSV (including CSV attributable to premiums paid by the Dynasty Trusts) would be paid to the CMM Trust. Additionally, if a split-dollar life insurance arrangement were to terminate as a result of the death of the insured, the Dynasty Trusts would be entitled to receive only that portion of the death benefit of the policy in excess of the receivable payable to the CMM Trust. Accordingly, under the split-dollar life insurance arrangements the Dynasty Trusts had no current or future right to any portion of the policy cash value, and thus, no current access under the regulations.

Respondent argues that the Dynasty Trusts had a direct or indirect right in the cash values of the insurance policies by virtue of the terms of the 2006 Amendment to the CMM Trust. Under that amendment, the CMM Trust's interest in the cash values of the policies would pass to the Dynasty Trusts or directly to Mrs. Morrissette's sons or their heirs upon her death. However, because the CMM Trust was a revocable trust with respect to Mrs. Morrissette, she retained an absolute right to alter the CMM Trust throughout her lifetime. Accordingly, the Dynasty Trusts did not have a legally enforceable right to the cash values of the policies during the lifetime of the grantor. Furthermore, the split-dollar life insurance arrangements did not require the CMM Trust to distribute the receivables to the Dynasty Trusts. Rather, Mrs. Morrissette retained the right to receipt of the receivables.

The IRS also argued this plan was analogous to reverse-split dollar plans:

Respondent argues that the circumstances referenced in Notice 2002-59, 2002-2 C.B. 481, apply to the split-dollar life insurance arrangements at issue prohibiting the use of the economic benefit regime. Notice 2002-59, sec. 3.01, 2002-2 C.B. at 482, states:

Treasury and the Service understand that, under certain split-dollar life insurance arrangements (some of which are referred to as "reverse" split-dollar), one party holding a right to current life insurance protection uses inappropriately high current term insurance rates, prepayment of premiums, or other techniques to confer policy benefits other than current life insurance protection on another party. The use of such techniques by any party to understate the value of these other policy benefits distorts the income, employment, or gift tax consequences of the arrangement and does not conform to, and is not permitted by, any published guidance.

Notice 2002-59, supra, is mainly focused on reverse split-dollar life insurance arrangements. Under a typical reverse split-dollar life insurance arrangement, an irrevocable life insurance trust (ILIT) purchases a large life insurance policy, and the insured and the ILIT enters into a split-dollar life insurance arrangement. Under this arrangement, the insured is entitled to the policy's death benefit and in return pays the ILIT the greater of the actual cost of one-year term insurance or the P.S. 58 rate.6 This arrangement is the opposite of the typical split-dollar life insurance arrangement and thus is referred to as "reverse split-dollar". Because life insurance costs have decreased substantially since the P.S. 58 rates were set by the IRS, the insured's payment of economic benefits using the P.S. 58 rates would be substantially greater than the actual mortality charges incurred by the ILIT. With a large policy, the insured could transfer significant sums to the ILIT and, on the basis of older IRS rulings, incur little or no gift tax costs. In the most abusive cases, the insured would prepay the P.S. 58 economic benefit amounts for several years. After a few years, the parties usually terminate the arrangement. The ILIT, flush with cash from the excess payments from the insured, either maintains the policy or cashes it out.

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The split-dollar life insurance arrangements between the CMM Trust and the Dynasty Trusts bear no resemblance to the transactions Notice 2002-59, supra, is prohibiting. Mrs. Morrissette, who was 94 at the time she set into motion these arrangements, wanted the Interstate Group to remain in her family. To that end, she caused the CMM Trust to pay a lump-sum premium, through the Dynasty Trusts, on the life insurance policies held on the lives of her sons, the proceeds of which would be employed to purchase the stock held by each of her sons upon his death. Unlike the reverse split-dollar life insurance arrangements described in the notice, the receivables the CMM Trust obtained in exchange for its advances provided the CMM Trust sole access to the CSV of the policies.

Additionally, respondent argues that the "prepaid premiums" pay not only for current insurance protection, but also for future protection, which is a benefit other than current life insurance protection and requires that the arrangement be taxed under the loan regime. This position relies on Notice 2002-59, supra, for the proposition that prepayment of future premiums (by paying a single premium) confers policy benefits other than current life insurance protection. This assertion, however, assumes that the Dynasty Trusts would otherwise be required to pay the premiums. Under the split-dollar life insurance arrangements, the Dynasty Trusts are not required, but are permitted, to pay any portion of the policies' premiums. The split-dollar life insurance arrangements were structured such that the CMM Trust was obligated to pay all the premiums. Thus, under the split-dollar life insurance arrangements, regardless of how the CMM Trust elected to pay the premiums (whether in one lump sum or over any number of installments), the CMM Trust would not relieve the Dynasty Trusts of any obligation to pay premiums because the Dynasty Trusts were not required to pay any premiums.

The risk to the taxpayer in these transactions is that the IRS will succeed on a claim that the prepaid premiums are a gift. The risk may be mitigated if a net gift is made. In Estate of Levine, T.C. No. 9345-15 (2016), the court followed Morrissette because all parties agreed it controlled.

The Tax Court denied the taxpayer’s motions for summary judgement on the application of section 2036, 2038, and 2703 to split-dollar policies in Cahill v. Commissioner, T.C. Memo. 2018-84. The court reviewed its understanding of the facts as follows:

In exchange for decedent's payment of $10 million as premiums on the policies for MB Trust's benefit, decedent[5](https://1.next.westlaw.com/Document/Ia948898074eb11e881e3e57c1f40e5c7/View/FullText.html?transitionType=UniqueDocItem&contextData=(sc.UserEnteredCitation)&userEnteredCitation=t.c.+memo.+2018-84#co_footnote_B00052044771917) received (and continued to own until he died) the right to terminate the split-dollar agreements in conjunction with the trustee of MB Trust. Each split-dollar agreement states that, upon termination, one of two things could happen: (1) MB Trust could opt to retain the policy, in which case decedent would immediately receive the greater of premiums paid or cash surrender value with respect to the related policy, or (2) MB Trust could decline its option to retain the policy, in which case the policy would be transferred to Northern Trust, N.A., in full or partial satisfaction of decedent's liability to Northern Trust, N.A. (We will refer to these as the termination rights.)

Additionally, each split-dollar agreement states that upon the death of the insured, decedent would receive the greatest of the remaining loan balance, premiums paid, or cash surrender value. (We will refer to these as decedent's death benefit rights.) MB Trust would receive any excess of the death benefits over the amount required to be paid to decedent. (We will refer to these as MB Trust's death benefit rights.)

On its estate tax return, the estate claimed that the aggregate value of all the rights decedent held under the split-dollar agreements, including the termination rights, was $183,700. The estate contends that (1) because decedent's right to terminate the split-dollar agreements was held in conjunction with the trustee of MB Trust and (2) because it would allegedly never make economic sense for MB Trust to allow termination of the split-dollar agreements, termination was so unlikely that the termination rights had no value as of decedent's date of death. On this basis, the estate contends that the value of decedent's interests in the split-dollar agreements is limited to the value of decedent's death benefit rights. The estate further contends that on decedent's date of death these rights were worth only $183,700, because Patrick and Shannon Cahill, the insured persons, were then projected to live for many years, with the result that decedent's rights had only a relatively small present value.

In the notice of deficiency respondent adjusted the total value of decedent's rights in the split-dollar agreements from $183,700 to $9,611,624; i.e., to the aggregate cash surrender value of the policies as of decedent's date of death. In support of this adjustment, respondent presents alternative theories applying [sections 2036(a)(2)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS2036&originatingDoc=Ia948898074eb11e881e3e57c1f40e5c7&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)), [2038(a)(1)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS2038&originatingDoc=Ia948898074eb11e881e3e57c1f40e5c7&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)), and [2703(a)(1) and (2)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS2703&originatingDoc=Ia948898074eb11e881e3e57c1f40e5c7&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)). The estate seeks summary judgment that [sections 2036](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS2036&originatingDoc=Ia948898074eb11e881e3e57c1f40e5c7&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)), [2038](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS2038&originatingDoc=Ia948898074eb11e881e3e57c1f40e5c7&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)), and [2703](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS2703&originatingDoc=Ia948898074eb11e881e3e57c1f40e5c7&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) are inapplicable; it looks for support for its position in [section 1.61–22, Income Tax Regs](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1016188&cite=26CFRS1.61-22&originatingDoc=Ia948898074eb11e881e3e57c1f40e5c7&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)).

The court concluded that those may, or may not, have been a bona find sale for full and adequate consideration:

There are many unresolved factual questions with respect to whether this transfer had a legitimate business purpose. For instance: (1) Were these arrangements actually intended to provide liquidity decades from now, or were they intended merely to eliminate the cash surrender value from decedent's estate? (2) The guaranteed return (3%) on the investment in the policies appears to be lower than the interest rate on the loan decedent used to purchase the policies (one month LIBOR plus 1.14%); taking into account all of the economic facts and circumstances, would this arrangement actually be capable of providing liquidity decades from now? How much liquidity, in present valued terms (i.e. valued to the date of execution)? At what cost, in present valued terms? And (3) why was an arrangement intended to provide liquidity potentially decades from now funded with a loan that required a balloon payment of the entire principal amount after only five years? That is, if decedent was acting as a prudent business person, why did he fund a long-term obligation with a short-term loan? Because such questions remain, summary judgment is inappropriate with respect to whether decedent's transfer of $10 million was part of a bona fide sale.

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According to the estate, at decedent's date of death MB Trust's ability to veto decedent's termination of the agreements rendered the termination rights valueless. Additionally, the estate alleges that decedent's death benefit rights are worth less than 2% of the cash surrender value (i.e., $183,700 ÷> $9,611,624 < 2%). But MB Trust's veto power existed from the moment decedent entered into these split-dollar agreements, and nothing in the undisputed facts presently before us suggests that the terms of the split-dollar agreements were altered between execution of the agreements and decedent's date of death; consequently, this alleged 98% discount must have been present from the execution of these agreements. Therefore, according to the estate's valuation theory, the initial transfer of $10 million in value cannot have been in exchange for property worth that amount; i.e., under the estate's argument, what decedent received was necessarily worth at least 98% less than what he transferred (even without taking into account the amounts used to pay commissions and fees to the insurance company). Consequently, at least according to the estate's valuation theory, the value of what decedent received (allegedly, something close to $183,700) was not even roughly equal to the $10 million decedent paid.

The court believes that section 2703 may apply on a simple reading of the statute:

On the basis of the undisputed facts, we conclude that under [section 2703(a)(1)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS2703&originatingDoc=Ia948898074eb11e881e3e57c1f40e5c7&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) the split-dollar agreements, and specifically the provisions that prevent decedent from immediately withdrawing his investment, are agreements to acquire or use property at a price less than fair market value. The estate claims that decedent paid $10 million to the insurance companies for the benefit of MB Trust and in return received certain rights, namely, the termination rights (which the estate claims are worthless) and decedent's death benefit rights (which, according to the estate's valuation theory, are worth less than 2% of the cash surrender value). MB Trust, meanwhile, paid nothing into this arrangement and received MB Trust's death benefit rights. As best we understand the estate's valuation theory, MB Trust's death benefit rights are allegedly worth at least the cash surrender value minus the value of decedent's death benefit rights (i.e., $9,611,624—(allegedly) $183,700 = $9,427,924). Nothing in the parties' filings suggests that MB Trust ever paid, or was obligated to pay, any interest or other amount to compensate decedent for MB Trust's acquisition and use of this amount.

The court rejected an analogy of a split-dollar agreement to notes or partnership and held that 2703 may apply:

We note that most of the estate's arguments with respect to [section 2703(a)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS2703&originatingDoc=Ia948898074eb11e881e3e57c1f40e5c7&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) are generally to the effect that, if [section 2703(a)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS2703&originatingDoc=Ia948898074eb11e881e3e57c1f40e5c7&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) applies in this case, it would also apply to all sorts of other options, agreements, rights, and restrictions. For example, the estate argues that “almost every two-party agreement has a restriction that one party cannot just unilaterally terminate the agreement.” The estate's implicit claim would appear to be that its hypothetical restriction is so obviously legitimate that Congress could not have meant for [section 2703(a)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS2703&originatingDoc=Ia948898074eb11e881e3e57c1f40e5c7&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) to apply. But [section 2703(b)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS2703&originatingDoc=Ia948898074eb11e881e3e57c1f40e5c7&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) provides the exceptions to application of [section 2703(a)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS2703&originatingDoc=Ia948898074eb11e881e3e57c1f40e5c7&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)); in particular, [section 2703(b)(3)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS2703&originatingDoc=Ia948898074eb11e881e3e57c1f40e5c7&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) specifically provides for comparison of the terms of the option, agreement, right, or restriction to “similar arrangements entered into by persons in an arms' length transaction.” The estate's vague and general arguments by way of comparison are therefore more appropriate as part of a section 2703(b)(3) analysis. And because the parties have yet to address whether [section 2703(b)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS2703&originatingDoc=Ia948898074eb11e881e3e57c1f40e5c7&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) applies in this case, we decline to consider it.

The case of Machacek v. Commissioner of the Internal Revenue, 906 F.3d 429 (6th Cir. 2018), dealt with an interesting split-dollar income tax question. The opinion summarizes the issue as follows:

Petitioners-appellants John J. Machacek, Jr. (John Machacek) and Marianne Machacek (together, the Machaceks), a married couple, were the sole shareholders of John J. Machacek, Jr., Inc. (Machacek, Inc.), a corporation organized under Subchapter S of the Internal Revenue Code (an S corporation). John Machacek was also an employee of Machacek, Inc. The Machaceks appeal the Tax Court’s ruling requiring them to treat as income the economic benefits resulting from Machacek, Inc.’s payment of a premium on John Machacek’s life insurance policy under a compensatory split-dollar arrangement. Relying on the compensatory nature of the arrangement, the Tax Court rejected the Machaceks’ argument that the economic benefits should be treated as a shareholder distribution.

Because the Tax Court did not consider the impact of a provision of the tax regulations specifically requiring that such economic benefits be treated as shareholder distributions, we reverse the Tax Court’s decision and remand for further proceedings consistent with this opinion.

**I. Background**

In 2002, Machacek, Inc. adopted the Sterling Benefit Plan in order to provide certain benefits to its employees. Pursuant to the plan, Machacek, Inc. provided John Machacek with a life insurance policy and paid the $100,000 annual premium in the 2005 tax year; both Machacek, Inc. and the Machaceks filed timely tax returns for that year. Because Machacek, Inc. is an S corporation, its income, losses, deductions, and credits are “passed through” to shareholders for tax purposes. Machacek Inc. deducted the $100,000 premium, and that amount was thus not included in the Machaceks’ individual income. The Machaceks also did not include as individual income the economic benefits flowing from the increase in value of the life insurance policy.

The Tax Court determined that Machacek, Inc. was not entitled to deduct the $100,000 premium payment. Because the $100,000 premium payment was not deductible, Machacek, Inc. underreported its income for that year and, due to the pass-through nature of S corporations, the increased income was passed through to the Machaceks, who were then required to pay income tax on that amount. The non-deductibility of the premium payment is not disputed, and the Machaceks concede that they must report the amount of the premium payment as pass-through income.

The dispute here concerns the tax treatment of the economic benefits flowing to John Machacek as a result of Machacek, Inc.’s payment of the premium. The parties dispute whether the Machaceks are required to report as taxable income—in addition to the pass-through amount of the premium—the economic benefits flowing from the increase in value of the life insurance policy caused by the payment of the premium.[1](https://1.next.westlaw.com/Document/I773d8dd0ce4811e88037ff68a1223ab1/View/FullText.html?transitionType=UniqueDocItem&contextData=(sc.DocLink)&userEnteredCitation=906+F.3d+429#co_footnote_B00012045712712)

The opinion is fascinating because the Court ultimately relied on a regulation uncited by either party. The taxpayer argued for a four step analysis:

At the first step, the Machaceks argue that notwithstanding that the economic benefits here flowed from a compensatory split-dollar arrangement, the regulations require that the economic benefits “be treated as a ‘distribution of property’ from the corporate-owner (Machacek, Inc.) to the non-owner (Mr. Machacek).” (Appellants’ Br. at 17.) This step of the argument relies on [26 C.F.R. § 1.301-1(q)(1)(i)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000547&cite=26CFRS1.301-1&originatingDoc=I773d8dd0ce4811e88037ff68a1223ab1&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_00ce000064fb7), which states that the provision of economic benefits “by a corporation to its shareholder pursuant to a split-dollar life insurance arrangement ... is treated as a distribution of property.” Neither the Machaceks nor the Commissioner addressed this regulation before the Tax Court, and the Tax Court made no mention of this regulation.

At the second step, the Machaceks point to the fact that “distributions of property” to a shareholder are ordinarily governed by [26 U.S.C. § 301(c)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS301&originatingDoc=I773d8dd0ce4811e88037ff68a1223ab1&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_4b24000003ba5). *See* [26 U.S.C. § 301(a)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS301&originatingDoc=I773d8dd0ce4811e88037ff68a1223ab1&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_8b3b0000958a4) (“[A] distribution of property ... made by a corporation to a shareholder with respect to its stock shall be treated in the manner provided in [[§ 301(c)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS301&originatingDoc=I773d8dd0ce4811e88037ff68a1223ab1&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_4b24000003ba5)].”).

At the third step, the Machaceks argue that Subchapter S—rather than [§ 301(c)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS301&originatingDoc=I773d8dd0ce4811e88037ff68a1223ab1&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_4b24000003ba5)—governs the treatment of the distribution here because Machacek, Inc. is an S corporation. *See* [26 U.S.C. § 1368(a)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS1368&originatingDoc=I773d8dd0ce4811e88037ff68a1223ab1&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_8b3b0000958a4) (“distribution of property made by an S corporation with respect to its stock to which (but for this subsection) [section 301(c)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS301&originatingDoc=I773d8dd0ce4811e88037ff68a1223ab1&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_4b24000003ba5) would apply shall be treated in the manner provided” by Subchapter S).

At the fourth step, the Machaceks argue that Subchapter S mandates that any shareholder distribution “taxable under the Subchapter S provisions ... would escape taxation under the split-dollar regulations.” (Appellants’ Br. at 17.)

The IRS thought that the mere fact that the arrangement was a compensatory split-dollar arrangement was determinative:

The Commissioner correctly notes that such treatment would be uncontroversial if the recipient of the economic benefits were an ordinary employee, rather than an S corporation’s shareholder-employee. The distinction between John Machacek’s different roles—employee and shareholder—is therefore key to the Commissioner’s position.

In response to the Machaceks’ reliance on [§ 1.301-1(q)(1)(i)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000547&cite=26CFRS1.301-1&originatingDoc=I773d8dd0ce4811e88037ff68a1223ab1&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_00ce000064fb7), the Commissioner points only to the distinction between compensatory and shareholder arrangements. The Commissioner recognizes that [§ 1.301-1(q)(1)(i)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000547&cite=26CFRS1.301-1&originatingDoc=I773d8dd0ce4811e88037ff68a1223ab1&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_00ce000064fb7) applies to both compensatory and shareholder arrangements but concludes that it “does not mean that in any situation where a compensatory arrangement covers a shareholder, the taxpayer’s status as a shareholder trumps his status as an employee, causing the economic benefit to be treated as a distribution to a shareholder,” because “[s]uch an interpretation of the regulation would make no sense, as it would defeat the reason for distinguishing between a compensatory arrangement and a shareholder arrangement.” (Appellee’s Br. at 37.)

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Finally, the Commissioner notes that “Machacek, Inc. will be entitled to a deduction in a future tax year,” pursuant to [26 C.F.R. § 1.83-6(a)(5)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000547&cite=26CFRS1.83-6&originatingDoc=I773d8dd0ce4811e88037ff68a1223ab1&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_488b0000d05e2), “when it actually transfers ownership of the policy to John Machacek.” (Appellee’s Br. at 41; *see also id.* at 26.) The Commissioner appears to rely on a possible future deduction as a way to counter the Tax Court’s acknowledgement that the result below “may seem aberrational.” The Commissioner argues that “it is [the Machaceks], not the Commissioner, who are arguing for an inequitable result under which they would escape taxation on the accumulation value of the policy, and realize an additional tax advantage when their corporation deducts the cost of the policy in the future.” (Appellee’s Br. at 41.) However, the Machaceks will also have personal tax consequences when the policy is transferred.

Finally, the Court reaches what it concludes is the dispositive regulation:

In finding for the Commissioner, the Tax Court did not address [26 C.F.R. § 1.301-1(q)(1)(i)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000547&cite=26CFRS1.301-1&originatingDoc=I773d8dd0ce4811e88037ff68a1223ab1&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_00ce000064fb7). Neither party cited or relied on this regulation below, and we are aware of no case discussing the regulation in any context. But given its importance in this scenario, we cannot simply ignore it. If the economic benefits to John Machacek are properly treated as a distribution of property to a shareholder—rather than as compensation to an employee—then the Tax Court erred.

[Section 1.301-1(q)(1)(i)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000547&cite=26CFRS1.301-1&originatingDoc=I773d8dd0ce4811e88037ff68a1223ab1&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_00ce000064fb7) is dispositive and renders irrelevant whether John Machacek received the economic benefits through a compensatory or shareholder split-dollar arrangement. [Section 1.301-1(q)(1)(i)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000547&cite=26CFRS1.301-1&originatingDoc=I773d8dd0ce4811e88037ff68a1223ab1&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_00ce000064fb7) treats economic benefits provided to a shareholder pursuant to *any* split-dollar arrangement as a distribution of property within the ambit of [§ 301](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS301&originatingDoc=I773d8dd0ce4811e88037ff68a1223ab1&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)). And, although another sub-section of that regulation, [26 C.F.R. § 1.301-1(c)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000547&cite=26CFRS1.301-1&originatingDoc=I773d8dd0ce4811e88037ff68a1223ab1&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_4b24000003ba5), states that the regulation as a whole “is not applicable to an amount paid by a corporation to a shareholder unless the amount is paid to the shareholder in his capacity as such,” the explicit inclusion in [§ 1.301-1(q)(1)(i)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000547&cite=26CFRS1.301-1&originatingDoc=I773d8dd0ce4811e88037ff68a1223ab1&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_00ce000064fb7) of all arrangements described in [§ 1.61-22(b)(2)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000547&cite=26CFRS1.61-22&originatingDoc=I773d8dd0ce4811e88037ff68a1223ab1&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_c0ae00006c482)—which includes compensatory arrangements—makes clear that when a shareholder-employee receives economic benefits pursuant to a compensatory split-dollar arrangement, those benefits are treated as a distribution of property and are thus deemed to have been paid to the shareholder in his capacity as a shareholder. The Commissioner offers no alternative interpretation that gives meaning to the inclusion of compensatory arrangements in [§ 1.301-1(q)(1)(i)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000547&cite=26CFRS1.301-1&originatingDoc=I773d8dd0ce4811e88037ff68a1223ab1&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_00ce000064fb7). Our interpretation is further supported by the fact that [§ 1.61-22(d)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000547&cite=26CFRS1.61-22&originatingDoc=I773d8dd0ce4811e88037ff68a1223ab1&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_5ba1000067d06) states that the tax treatment of the economic benefits depends on the “relationship between the owner and the non-owner.” The Commissioner argues that this language shows that the tax treatment depends on the nature of the split-dollar arrangement—compensatory or shareholder—but if that were the controlling factor, the regulation could have said so. It does not.

The Tax Court issued another opinion dealing with various issues in Morrisette on May 13, 2021. Estate of Morrissette v. Comm’r, T. C. Memo. 2021-60 (hereinafter referred to as Morrissette II). In general the opinion was favorable to the taxpayer. The court held that sections 2036 and 238 did not pull the policy proceeds into the grantor’s estate because the arrangement was based on a sale for full and adequate consideration, that section 2703 did not apply which would have included the underlying cash surrender value of the policies in the decedent’s estate, and that the fair market value could be calculated using discounted cash-flow. Nonetheless the court found the 40% gross valuation misstatement penalty (section 6662(h) was appropriate. With the generous permission of Howard Zaritsky, his discussion and comment on Morrissette II is as follows:

The Tax Court ruled in *Morrissette II* that: (a) the policy proceeds are not includible in the gross estate of the deceased grantor of the revocable trust under Sections 2036 or 2038, because they were made in a *bona fide* sale for adequate and full consideration; (b) the special valuation rules of Section 2703 do not require inclusion of the cash surrender value of the policies in the decedent’s gross estate; (c) the fair market values of the decedent’s split-dollar rights could be calculated using the discounted cash value methodology; and (d) a 40% gross valuation misstatement penalty under Section 6662(h) was appropriate.

The Tax Court (Judge Goeke) reviewed the facts in even greater detail that he had in the earlier opinion of the court and noted that, while the petitioners agree that the fair market values of the split-dollar rights are includible in Mrs. Morrissette’s gross estate because they were held by her revocable trust, the IRS sought to include the $30 million in premium payments or the $32.6 million in cash surrender value in the decedent’s gross estate under Sections 2036 and 2038. The IRS argued, as it had in *Cahill*, that the revocable trust, through the split-dollar agreement, had retained the possession, enjoyment, or right to income in the transferred funds under Section 2036(a)(1), a power to designate the beneficial enjoyment of the transferred funds under Section 2036(a)(2), or a power to alter the transferred funds under Section 2038(a). As the Tax Court in *Cahill* had already stated that the rights retained in an intergenerational split-dollar life insurance agreement fell under Section 2036(a)(2) or 2038(a) (the application of Section 2036(a)(1) was not considered in that case), the court did not need to re-evaluate that issue here, but instead focused on the bona fide sale exception to both Sections 2036 and 2038.

The IRS also contended that the transfer was not a bona fide sale for adequate and full consideration, but the Tax Court disagreed. The Tax Court applied the same analysis in *Morrissette II* that it had applied in*Estate of Powell at* 411 (2017), that the bona fide sale exception requires both (1) a legitimate and significant nontax purpose and (2) adequate and full consideration for money or money’s worth. The court rejected the IRS argument that the transfers between the revocable trust and the dynasty trusts were not a “sale” as that term is ordinarily defined, because the dynasty trusts paid no consideration. The court pointed out that Section 2036 and 2038 adopt a broader definition of “sale,” that includes transactions that are not commonly categorized as sales. Basically, they require only a voluntary act of transferring property in exchange for something. *Estate of Bongard v. Comm’r*, 124 T.C. 95, 113 (2005). *Estate of Stone v. Comm’r*, T.C. Memo. 2003-309 (treating a contribution of assets to a business entity in exchange for an interest in the entity as a sale for purposes of section 2036(a)). In *Morrissette II*, the revocable trust voluntarily and in good faith transferred money to the dynasty trusts in exchange for a right to repayment. Thus, the split-dollar agreement between the revocable trust and the dynasty trusts was a sale for this limited purpose.

The court then held that Clara had a legitimate and significant nontax motive for advancing the funds to pay the premiums under the split-dollar agreement. The court explained that the nontax purpose must be a genuine purpose that motivates the transaction, rather than a theoretical purpose or justification. *Estate of Bongard*, 124 T.C. at 118. The existence of additional testamentary objectives, however, does not negate the existence of a legitimate nontax purpose, as such purposes are often inextricably interwoven. *Estate of Bongard*, 124 T.C. at 121; *Estate of Black v. Comm’r*, 133 T.C. 340, 362-363 (2009).

The evidence established that Clara sought to maintain control over the company and to pass that control on to her sons and future generations. The split-dollar agreements were instrumental in accomplishing these objectives and assuring the control and succession of an active closely-held business is a legitimate nontax purpose for the *bona fide* sale exception. to ensuring that Interstate’s ownership remained in her family after her sons died. Citing *Estate of Bigelow v. Comm’r*, 503 F.3d 955, 972 (9th Cir. 2007), *aff’g* T.C. Memo. 2005-65; *Estate of Strangi v. Comm’r*, 417 F.3d at 481; *Estate of Reynolds v. Comm’r*, 55 T.C. 172, 194 (1970). The court explained that:

*The brothers wanted to honor their parents’ wish that the three brothers inherit Interstate equally and pass the company on to their children. However, they were also realistic about the need to pay estate tax and the possibility that they would need to sell part of Interstate to pay it. They believed that there was a significant chance that the family would lose control of Interstate if their families were not given this option . . . . The split-dollar agreements provided each brother’s children with the option to exit the business and cash out their interests after the brother’s death and at the same time allowed the remaining brothers and their families to purchase the interests by funding the buyout. The buy-sell provision also prevented the brothers from selling their Interstate stock to outsiders as a means to retaliate against one another for past disputes.* T.C. Memo. 2021-60 at \*76.

The court also held that the split-dollar agreements served a second legitimate, nontax purpose, a smooth transition in Interstate’s management. The agreements helped assure that those sons who had long worked for the company could remain with the company for their professional futures, preserving both their expertise and institutional knowledge. The court found testimony from these sons about their succession concerns to be credible.

The court acknowledged that the split-dollar agreements were also part of an estate tax saving strategy. Nonetheless, the existence of a tax motivation does not negate the existence of a legitimate nontax motive. As the court explained, “caselaw requires the presence of a legitimate, nontax purpose; it does not require the absence of a tax saving motivation.” T.C. Memo. 2021-60 at \*78. One son “who made most decisions relating to the split-dollar agreements, credibly testified that he would have engaged in the split-dollar agreements even if they had not provided any estate tax saving because of the nontax financial benefits that they provided.” *Id.* Furthermore, the court found that the record showed the sons concerns about the correct inheritance of the company and that these were not merely theoretical justifications for the agreements.

The court rejected the argument that if the sons “stood on both sides of the split-dollar agreements,” there could be no legitimate nontax purpose. A taxpayer’s standing on both sides of a transaction can indicate there is no legitimate, nontax purpose for the transfer, but it is not conclusive. *Estate of Thompson v. Comm’r*, 382 F.3d 367, 382 (3rd Cir. 2004), *aff'g* T.C. Memo. 2002-246. This is particularly true when the relationship of sons, as here, was occasionally hostile. See *Estate of Stone* (resolving intrafamily disputes that had led to litigation in the past is a legitimate, nontax purpose).

The IRS also argued that the sons had complete control over the policies and could cancel them at any, because the dynasty trusts would inherit the split-dollar rights. The court rejected this argument because, while the sons, as co-trustees, had the discretion to distribute each split-dollar agreement, such distribution was not guaranteed. Moreover, the effects of the possible distribution of the split-dollar agreements after Clara’s death were more relevant to the determination of the fair market value of the split-dollar rights then to whether the transfers qualified as bona fide sales. The parties to the buy-sell agreement understood their future obligations and there was credible testimony that there was no prearranged plan to terminate the split-dollar agreements upon Clara’s death.

The court rejected the government’s argument that purchasing life insurance policies with high initial cash values and modest death benefits proved that tax motivations were primary. The court noted that the sons had credibly testified that they choose those policies to ensure that the revocable trust would be adequately compensated for financing the premiums and that it would earn interest for funding the premiums through inside buildup in the value of the policies.

The court also rejected the IRS argument that the fact that the sons retained their father’s stock after his death and the equal distribution of the insurance proceeds among the dynasty trusts showed that the buy-sell provision was not a legitimate reason for the transfer of the premiums. The court stated that it made sense that two of the sons would retain their father’s voting stock as they worked for the company and they wanted to protect their careers.

The court also held that the revocable trust had received adequate and full consideration in money or money’s worth for its premium payments. The court rejected the estate’s argument that the fact that the transaction complied with the requirements of the economic benefit regime should mean that there was adequate and full consideration, because the regulations expressly do not apply for estate tax purposes. The economic benefit regime does not require a comparison of the amount of the premium payment with the value of the rights that the revocable trust received in exchange.

The court noted that, unlike the question of fair market value, the adequacy of consideration is not defined on the basis of a willing buyer and willing seller and is not judged from the perspective of hypothetical persons. *Kimbell v. United States*, 371 F.3d 257, 266 (5th Cir. 2004). The bona fide sale exception does not require an arm’s-length transaction and an intrafamily transfer, though requiring heightened scrutiny, can constitute a *bona fide* sale. *Estate of Bongard*, 124 T.C. at 122-123; *Estate of Thompson*, 382 F.3d at 382-383. The question of adequacy of consideration requires that the consideration be similar to that which two unrelated persons would provide after negotiating at arm’s length. *Estate of Bongard*, 124 T.C. at 122-123. In *Kimbell*, 371 F.3d at 265-266, the Court of Appeals for the Fifth Circuit acknowledged that an investor received a partnership interest for adequate and full consideration even though the partnership interest had a substantially lower fair market value than the assets contributed to the partnership. The key is whether the exchange is an informed trade, and investors may desire an asset for features other than its fair market value, such as “management expertise, security or preservation of assets, and capital appreciation.” *Estate of Thompson*, 382 F.3d at 381. Here, the split-dollar agreements provided financial benefits other than the ability to sell or collect immediately on the split-dollar rights, including repayment plus inside buildup in the value of the policies, management succession, and efficiency and capital accumulation.  The court noted that the intervening events between the transfer date, when one determines adequate and full consideration, and the valuation date, when one determines fair market value, which were significant. Clara had been in relatively good health on the transfer date, and one of the sons had been diagnosed with terminal cancer and was no longer even insurable. Clara could have outlived any one of her sons, and the split-dollar agreements were a safe investment with an adequate interest rate.

The court held that the revocable trust received adequate and full consideration on the basis of the split-dollar agreements’ repayment terms that included interest earned in the form of inside buildup of the insurance policies. The minimum interest rates and the actual appreciation in the policies’ cash values were higher than the interest rates that the CMM trust had been earning on the money. Respondent does not argue that the repayment terms were inadequate. The split-dollar agreements also provide the additional benefit of deferral of tax on the policies’ inside buildup and the tax-exempt payout of the death benefits to the beneficiaries.

The court distinguished the facts in *Cahill*, noting that the decedent in *Cahill* was 90 years of age, while the decedent in *Morrissette II* was 75 years old, and the decedent in *Estate of Cahill* borrowed the entire $10 million premium payments from a bank while Clara had sufficient assets to pay almost 90% of the premiums herself, as well as other sources of income to repay the small loan she did obtain from the company. Perhaps more importantly, *Cahill,* unlike *Morrissette II,* did not involve active business operations and such financial considerations as management efficiency and succession, capital accumulation and family dynamics that put those financial considerations at risk. The split-dollar agreements in *Estate of Morrissette II* provided financial benefits similar to those in *Kimbell* and unlike those in *Cahill*.

The court noted that in this case, the estate tax saving was achieved not through execution of the split-dollar agreements alone, but rather through the undervaluation of the split-dollar rights. In exchange for $30 million, the dynasty trusts agreed to buy life insurance and repay the revocable trust and Clara still held the contract rights at the time of her death. However, she no longer had use of or access to the $30 million. Thus, the split-dollar agreements changed the nature of the revocable trust’s relationship with the funds that it had transferred.

The court also held that Section 2703(a) did not apply to this arrangement, in a very rare victory for the taxpayer under this section. The court held that the split-dollar agreements were part of a *bona fide* business arrangement, not a device to transfer property at less than adequate and full consideration, and that its terms were comparable to similar arrangements entered into at arm’s length.

The court explained that, for this purpose, a bona fide business agreement must further some business purpose. *Amlie v. Comm’r*, T.C. Memo. 2006-76. Such a purpose was established by the estate, as discussed above.

Regarding whether the agreement was a device to transfer property for less than adequate and full consideration, the court agreed with the government that some facts indicated a testamentary purpose for the split-dollar agreements, but that the mutual termination restriction was not itself a device. Device status depends in part on the fairness of the consideration received by the transferor. See *Estate of True v. Comm’r*, T.C. Memo. 2001-167, aff’d, 390 F.3d 1210 (10th Cir. 2004). Here, split-dollar agreements contained reasonable repayment terms, including an inside buildup at a guaranteed interest rate of 3% (and an actual rate of between 4.75% and 5.4%), which was comparable to long-term bonds and actually higher than the revocable trust had been earning on the transferred funds. In light of these and the other intangible benefits discussed above, the court held that the mutual termination restriction was not a device.

On whether the mutual termination restriction was comparable to split-dollar agreements between or among unrelated persons in an arm’s-length transaction, the court rejected the analysis of the IRS expert, who compared the Morrissette split-dollar agreements with those entered into by publicly-traded corporations to compensate executives. The court rejected these as having “little relevance to ascertaining whether a closely held corporation or its majority shareholder would include a mutual termination restriction in a split-dollar agreement.” T.C. Memo 2021-60 at \*104. Also, the government instructed its expert to consider only policies owned by corporate employers, which were not applicable in this case where the corporation had no interest in the policies; the policies were owned by the dynasty trusts. The court noted that the government could not justify this limitation on the policies considered by its expert.

Additionally, the split-dollar agreements reviewed by the government’s expert included some type of restriction on the employer’s right to terminate the agreement unilaterally, such as vesting for years of service. Here, the senior executives had worked for the company for over 40 years and the court stated that:

[l]ong-term senior executives would likely demand a mutual termination restriction comparable to the one at issue, and the reviewed agreements provide vesting provisions. The mutual termination restriction would ensure the executives’ rights to the net death benefits similar to vesting in employment compensation packages on the basis of years of service. In total, approximately 30% of the public agreements imposed some restriction on the employer’s termination rights. The termination rights of another 13% are not as clear as respondent argues.T.C. Memo 2021-60 at \*105.

The taxpayer was less successful in sustaining a $7.5 million valuation for the decedent’s rights under the split-dollar agreements. The court explained that there were two differences between the analyses of the estate’s experts and the government’s expert: (a) computation of the probability-adjusted expected values of the policies; and (b) the applicable discount rates to determine the present value of those expected returns. The experts differed on both issues, but far more significantly on the second than on the first.

Each expert determined a probability-adjusted expected value for each year of the brothers’ life expectancies by estimating an expected cash surrender value for each year and multiplying that value by the brothers’ probabilities of mortality that year. On the expected value of the policies, one of the estate’s experts valued the split-dollar rights at $7,808,314. The court rejected this valuation because the estate’s expert used a blended yield rate that placed too much weight on anticipated decreases in the actual policy yields, and thereby inappropriately decreased the expected cash surrender values. The court also rejected this valuation because the expert used policy illustrations that were not issued close to the valuation date, which the court noted involve subsequent events that were not foreseeable on the valuation date are not, therefore, generally helpful. Citing *Messing v. Comm’r*, 48 T.C. 502, 509 (1967).

Both of the estate’s experts used the IRS mortality table for to determine the probability of each insured dying in each year. Actually, the government’s expert used tables that provided a lower valuation for the estate, which the court treated as a concession.

The court accepted the discount rates of 8.85% and 6.4% (different rates for different insurers) proposed by the government’s expert, finding that they more accurately reflected the risk that the insurers would default on their payment obligations under the policies.  That expert used yields that were lower than the average historic yields for both insurers, because interest rates for U.S. Treasury bonds were at a 50-year low. The court held that considering the spot yields on U.S. Treasury bonds more accurately captured the market conditions on the valuation date. The court also held that the actuarial tables negated the argument that it was difficult to determine the timing of the repayments (although a standard actuarial table does little to predict when one of the insured Morrissette sons would actually die).

The estate’s experts used life settlement yields as the discount rate, producing a range of yields from 15% to 18% (one expert) or from 9.3% to 23.2% (the other expert). The court rejected these yields because life settlement yields require information regarding the varying sizes of the underlying policies, the financial strength of the insurance companies, the insureds’ medical histories, mortality assumptions, and continued obligations to pay premiums. Most of this information was not available to the court. The court stated that, “[w]ithout more information, it is not possible to place the split-dollar agreements accurately within that range.” T.C. Memo 2021-60 at \*115.

More importantly, the court agreed with the government that the sons likely intended to terminate the split-dollar agreements on December 31, 2013 (when the statute of limitations on estate tax deficiencies regarding Clara’s estate return expired), and that this should be deemed to be the maturity date of the policies, producing a fair market value of $27,857,709. The court noted that the revocable trust agreement provided that the split-dollar rights would be allocated to the respective dynasty trusts that owned the underlying policies, which would give the dynasty trusts full control over the policies and allow them to terminate the agreements on December 31, 2013.

The court also sustained a 40% gross valuation misstatement penalty with respect to the valuation of the split-dollar agreement rights held by Clara’s estate. It rejected claims that the penalties were never approved by the agent’s supervisors, as required under Section 6751(b). While the approval had been done without great formality, such formality is not required and the court found adequate evidence to sustain the penalty as having been approved.

The court also held that the estate had not reasonably relied on the opinions of its valuation experts. Reliance on professional advice may provide a reasonable cause defense if, under all the circumstances, the reliance was reasonable and in good faith. *Neonatology Assocs., P.A. v. Comm’r*, 115 T.C. 43, 98-99 (2000), *aff’d*, 299 F.3d 221 (3d Cir. 2002). The court stated that the estate’s $7.5 million appraisal was not reasonable and the sons should have realized it. Despite the business and other nontax purposes for entering into the split-dollar agreements, the sons knew that these arrangements were being marketed as an estate tax saving strategy, and that the tax benefits would be obtained through the low valuation of the split-dollar agreements. The only purpose for valuing the split-dollar rights at $7.4 million rather than the $30 million that the revocable trust actually paid was estate tax saving.

*Morrissette II* suggests that intergenerational split-dollar life insurance arrangements may work, though only in certain specific situations. First, there must be a bona fide nontax purpose for the arrangement. There was none in *Cahill*, but the business succession issues in *Morrissette II* provided a clear and substantial nontax purpose. Once such a purpose exists, the co-existence of tax motivations may not be a problem.

Second, the planned disposition of the decedent’s rights under the split-dollar agreement to the trusts for the insureds and their descendants proved problematic in *Morrissette II*. This was the basis by which the Tax Court valued the retained rights under the split-dollar agreements at a figure far in excess of the actuarial value that the taxpayer reported on the decedent’s estate tax return. Had these rights be left to, for example, a separate common trust fund for the descendants of the deceased, rather than to the specific dynasty trusts that owned the policies themselves, a different and more favorable result might have been achieved.

This aspect of the Morrissette II opinion is questionable. Clara’s rights under the split-dollar agreements should be valued as of the date of her death based on the price a hypothetical unrelated person would pay for those rights. Instead, the court determined the value of those rights taking into account (a) the specific rights in the split-dollar agreements which the dynasty trusts received from the revocable trust as a result of Clara’s death, and (b) the specific rights the dynasty trusts acquired when they entered into the split-dollar agreements. Under that analysis, the split-dollar agreements terminated, and each dynasty trust acquired complete control of the underlying policies which insured the life of the other two Morrissette sons pursuant to the cross-purchase arrangements. A hypothetical unrelated person who purchased the Receivables would not have had the right to terminate the split-dollar arrangements. Moreover, since the court found that one of the insured Morrissette sons was diagnosed with terminal cancer before the estate filed its estate tax return, and a second son died of brain cancer shortly thereafter, it is unlikely that the independent trustees of the dynasty trusts would have agreed to terminate the policies to obtain the cash surrender values.

Third, Section 2703, while devastating in *Cahill*, was surmounted by the taxpayer in Morrissette II principally because of the existence of a clear and substantial nontax business purpose for the agreements. One would, of course, still would have to establish that the terms of the agreement are comparable to similar arrangements entered into by persons in an arms’ length transaction, but it seems likely that this will be relatively easy to overcome if there is a substantial nontax business purpose for the agreements.

Fourth, the decedent’s arguments in *Cahill* were weakened because the transaction was negotiated between the trustee of the revocable trust (the decedent’s son and attorney-in-fact) and his cousin (the trustee of the MB Trust). The transaction would have had far more credibility were the trustees independent and unrelated to each other. Obviously, this increases the cost of the transaction, but it is a small price to pay to give the arrangement a far more bona fide appearance.

Fifth, the use of a third-party loan to pay the life insurance premiums is not inherently inappropriate or disqualifying, but the existence of sufficient personal assets to make these payments was cited favorably by the court in *Morrissette II*. Also, it is likely that the lender required that the decedent in *Cahill* have the right to terminate the agreement, at a minimum with the consent of the trustee of the MB Trust. Also, the existence of the loan raises the presumption that the donor anticipates getting the cash out of the policy not later than when the loan becomes due. Thus, it is better if the premiums are paid from assets already held by the expected decedent, or from money borrowed against assets other than the policy.

Another approach would be to eliminate entirely the right to terminate the agreement that was deemed a power under Section 2036(a)(2) and 2038. In both *Cahill* and *Morrissette*, this power was expressly provided by the split-dollar agreement. A court has reason to be skeptical about any power of the donor to require that the policy be cashed-in, either alone or together with the donee, because the donor no longer owns the policy. The right to cash-in the policy ought to rest with the policy owner. Where a donor borrows to pay the premiums and must use the policy as security for the loan, it is likely that the lender will require that the donor have the ability to reach the cash values. Otherwise, however, such a provision is really not essential to the validity of the split-dollar agreement or the effectiveness of the arrangement. The agreement should provide what happens when the insured dies (that the premiums or cash value are repaid), and it should provide what happens if the policy is cancelled (repayment of the cash value), but it need not provide what happens if the agreement itself is terminated. Generally, contracts presume that they will be implemented, rather than terminated.

The split-dollar agreement could, instead, be silent on termination and assume that the payments by the decedent will be repaid when the insured dies or the policy is cancelled. Moreover, it could grant the right to terminate the policy and the agreement solely to the donee—the irrevocable trust. This seems both reasonable from a business standpoint, because it vests the right to terminate in the policy’s actual owner, and prudent from an estate tax standpoint, because it deprives the donor of any power that could be classified as a right to control beneficial enjoyment under Section 2036(a)(2) or a right to alter or amend beneficial enjoyment under Section 2038.

Clients may object because they fear that circumstances may change and they may need to recover cash from the policy. This is not a serious problem, however, because general contract law provides that all of the parties to a contract can agree to terminate it by mutual consent.See, e.g., 29 Williston on Contracts § 73—Elements of Rescission (4th ed.). Thus, the provision in *Cahill* did not really give the donor anything that he did not already have. A right afforded by state law, however, is not a retained right to alter, amend, revoke, or terminate or to control beneficial enjoyment for estate tax purposes. *Helvering v. Helmholz*, 296 U.S. 93 (1935).

In light of the current low applicable federal rates (AFR), one could also consider replacing an economic benefit split-dollar agreement with a simple promissory note, providing for annual payments of interest at the relevant AFR, until the death of the insured, and for repayment of the entire principal at that time. The Tax Court in *Cahill* recognized that Sections 2036 and 2038 did not apply to a simple promissory note and took pains to distinguish a split-dollar agreement from a promissory note. The taxpayer may thus accept this analysis and, instead, lend the irrevocable trust an amount sufficient to pay the premiums on the insurance policies. The parties should also comply with the safe harbor under Reg. § 1.7872-15, by filing the IRS statement for each nonrecourse loan that a reasonable person would expect repayment in full.

Of course, arrangements would have to be made for paying the interest on the loan currently. Such arrangements could involve additional gifts, withdrawals from the policy cash values, or annual deemed gifts of the unpaid interest. The discount for the promissory note is likely to be less than comparable to that for a split-dollar agreement, but it should still be significant because (a) the term of the note is both uncertain (the death of the insured) and far into the future, and (b) the AFR rates are currently substantially below market interest rates. This approach also has the double benefit of simplicity and clarity. It is far less complex to draft than an intergenerational split-dollar agreement, and the parties are far more likely to understand its terms than they are those of an intergenerational split-dollar agreement.

# SECTION 2053 and 2054 - DEBTS AND ADMINISTRATION EXPENSES

# SECTIONS 2056, 2056A AND 2519- MARITAL DEDUCTION

## **Termination of QTIP Trust Creates Double Gifts**

**.** CCA 202118008 involved simple facts and a most unfortunate result. Surviving spouse was the beneficiary of a QTIP trust, received all the income of course, could receive principal for health, maintenance, and support in the spouse’s accustomed standard of living if the income were insufficient, and had a testamentary power of appointment among descendants. Apparently for planning purposes, the spouse and descendants decided to terminate the trust and give all of the trust assets back to the spouse who then disposed of the assets in what appear to be sales and perhaps other estate planning transactions. The National Office determined that spouse made a gift of the value of the QTIP assets when the trust was terminated, and that the descendants made a gift of the value of their remainder interests. There was no offset for the respective gifts, and the transaction was not treated as a sale. The termination was done via a commutation agreement that the CCA describes this way:

On Date 3, Spouse, as the current beneficiary and as the trustee of Trust 1, and Child 1 and Child 2, as remainder beneficiaries and virtual representatives of the contingent and unborn beneficiaries of Trust 1, entered into Agreement. Under the terms of Agreement, Trust 1 was commuted1 and all of its property was distributed to Spouse. Recital H of Agreement provides that Spouse and Children agree that “Trust assets could be more effectively utilized if [Spouse] held such assets outright and free of trust.” In Recital F of Agreement, the parties acknowledge that Spouse’s testamentary limited power of appointment is “not operative.” Paragraph 3 of Agreement provides:

By signing this Agreement and by virtue of the QTIP election for the Trust, the commutation of the Trust results in a deemed gift, for federal gift tax purposes, of the remainder interest in the Trust assets from [Spouse] to [Children] under Section 2519 of the Code. By virtue of the distribution of all of the Trust assets to [Spouse], the commutation of the Trust does not result in a deemed gift of [Spouse’s] income interest in the Trust under Section 2511 of the Code. Additionally, by signing this Agreement and by virtue of the distribution of all of the Trust asset [sic] to [Spouse], the commutation of the Trust results in a gift, for federal gift tax purposes, of the remainder interest in the Trust from [Children] to [Spouse]. The deemed gift of the remainder interest from [Spouse] to [Children] and the gift from [Children] to [Spouse] results in a reciprocal gift transfer.

First up to be considered were the tax consequences to the spouse. The CCA states:

In this case, Spouse, as personal representative of Decedent’s estate, made an election under § 2056(b)(7) to treat Trust 1 as QTIP and claimed a marital deduction on Decedent’s Form 706 for the value of Trust 1. Years later, on Date 3, Spouse and Children entered into Agreement. By its terms, Agreement effected the commutation of Trust 1.

In a commutation, the trustee makes terminating distributions to the holders of the beneficial interests in the trust equal to the actuarial value of the interests. Each beneficiary gives up his or her respective beneficial interest in exchange for a lumpsum payment, in what is essentially a sale transaction. The commutation terminates any relationship between the beneficiary and the trust, and if all interests are commuted, the trust terminates.

Based on the above, the commutation of Trust 1 effected by Agreement constitutes a disposition by Spouse of Spouse’s qualifying income interest within the meaning of § 2519(a). Section 25.2519-1(a) and (f); *Estate of Novotny*. Accordingly, for gift tax purposes, Spouse is treated as transferring by gift all interests in Trust 1 other than the qualifying income interest.3

Footnote 3 states:

Note that the commutation does not constitute a gift of Spouse’s qualifying income interest under § 2511 because Spouse received adequate and full consideration for Spouse’s qualifying income interest based on the distribution of all trust property to Spouse. *See* § 25.2519-1(g), *Example 2*.

The CCA summarized the Estate of Novotny, 93 T.C. 12 (1989) like this: the surviving spouse and remainderman divided the sale proceeds of QTIP proportionately on the basis of the respective values of their interests; the court indicated that the commutation constituted a disposition by the spouse of the income interest for purposes of § 2519 and was thus subject to gift tax.

So, the QTIP was terminated, the spouse received all the QTIP assets, and the spouse made a gift of the value of those assets to the descendants. Now let’s look at the what the descendants did. Before the termination they would have received the assets when the spouse died. The CCA provides as follows:

In this case, Child 1, Child 2, and Spouse entered into Agreement, which legally bound all persons interested in Trust 1. The effect of Agreement was to extinguish Spouse’s testamentary limited power of appointment, commute Trust 1, and terminate Trust 1. As a result, Agreement vested a valuable property interest (the value of the remainder) in Children, the then remaindermen. Rather than accept a terminating distribution of the value of their beneficial interest, Child 1 and Child 2 agreed that the trust property “could be more effectively utilized” by Spouse holding the property outright. The outright distribution of all trust property to Spouse pursuant to the terms of Agreement constitutes a transfer of the value of Children’s remainder interests without receipt of adequate and full consideration.4 Accordingly, Child 1 and Child 2 each made a gift under § 2511 of the value of their respective remainder interest in Trust 1 to Spouse. Section 2512(b).

Footnote 4 is omitted and deals with spouses’ subsequent transfers.

The children argued that there had to be some offset here, otherwise the property was being taxed twice. The National Office rejected that position stating:

In *Commissioner v. Wemyss*, 324 U.S. 303 (1945) and its companion case *Merrill v. Fahs*, 324 U.S. 308 (1945), the Supreme Court considered the gift tax meaning of the term “adequate and full consideration in money or money’s worth” in the context of antenuptial contracts.

In *Wemyss*, the donor transferred assets to his fiancé to compensate her for the loss of an income interest that would terminate upon her marriage to him. There was no dispute that both a promise of marriage and detriment to a contracting party constituted valuable consideration for purposes of the law of contracts. The Tax Court had held that if the promise of marriage was the consideration, it was not one reducible to a money value and, if the fiancé’s loss of the income interest was the consideration, it did not constitute consideration in the hands of the donor. The Supreme Court stated:

If we are to isolate as an independently reviewable question of law the view of the Tax Court that money consideration must benefit the donor to relieve a transfer by him from being a gift, we think the Tax Court was correct. . . . The section taxing as gifts transfers that are not made for “adequate and full (money) consideration” aims to reach those transfers which are withdrawn from the donor’s estate.

*Wemyss*, 324 U.S. at 307-08. In other words, valuable contractual consideration in the hands of the donor is not sufficient; adequate and full consideration is that which replenishes, or augments, the donor’s taxable estate.

In *Merrill,* the donor transferred property to donor’s then spouse in exchange for spouse’s relinquishment of marital rights in donor’s remaining property. The Court held that spouse’s relinquishment of the marital rights did not constitute adequate and full consideration for donor’s transfer because the assets subject to the marital rights were already includible in donor’s gross estate. *Id*. at 312-13.

Rev. Rul. 69-505, 1969-2 C.B. 179, involves a transfer to a trust of joint-tenancy property that is treated as a reciprocal exchange for consideration in money or money’s worth. A and B owned the property as joint tenants and could each unilaterally sever the joint tenancy, and if not severed, the property would pass to the survivor upon the death of the other joint tenant. A and B transferred the property to a trust, reserving the right to receive one-half of the income therefrom for their joint lives and all to the survivor for life with remainder to C. Citing § 25.2511-1(e) and *U.S. v. Estate of Grace*, 395 U.S. 316 (1969), the revenue ruling holds that the transfers between A and B are treated as a reciprocal exchange for consideration in money or money’s worth. Thus, neither A nor B made a gift to the other to the extent that the transfers were of equal value. The revenue ruling concludes that since the value of the gift by B is less than the value of the gift by A, A is deemed to have made a gift to B of the difference in value of A’s and B’s transfer.

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Agreement characterized the transaction as a commutation of Trust 1 followed by a distribution of all trust property to Spouse. Thus, Spouse agrees to the extinguishment of Spouse’s lifetime interest in Trust 1 and Children agree to the extinguishment of their remainder interest in Trust 1 in exchange for receipt of their respective proportionate share of trust property. Also pursuant to Agreement, Children transfer their proportionate share of trust property received in the commutation to Spouse and receive no consideration from Spouse in exchange for the transfer. Absent entering into Agreement, Spouse had no right to the remainder under the terms of Trust 1 or otherwise. Therefore, from an economic perspective, the transaction resulted in a one-sided gift transfer from Children to Spouse.

It is the deemed gift transfer arising by application of § 2519(a) that is the crux of Spouse and Children’s position, as stated in Agreement, that the transfers are reciprocal gift transfers. However, unlike in Rev. Rul. 69-505, Spouse’s deemed transfer under § 2519(a) and Children’s transfers of their remainder interests under § 2511 do not constitute offsetting exchanges of consideration. Spouse received no consideration for the deemed transfer to Children under § 2519(a). That is, because the entire value of Trust 1 was subject to inclusion in Spouse’s gross estate under § 2044, the transfer of the remainder by Children to Spouse does not augment Spouse’s estate and, thus, cannot constitute the receipt of adequate and full consideration for gift tax purposes. *See Commissioner v. Wemyss; Merrill v. Fahs.*

The fact that Spouse can receive no consideration for the deemed transfer resulting from the application of § 2519(a) does not nullify Children’s transfers of their remainder interests in Trust 1. When Trust 1 was commuted, the remainder interest vested outright, equally in Children, the then remaindermen. Children then transferred their valuable property interest to Spouse and received nothing in exchange. Under § 2512(b) and *Wemyss*, these transfers by Children for no consideration constitute a gift. If Children were to transfer their remainder interests to a third party other than Spouse, the transfers would clearly be a gift. The result is the same if the donee is the surviving spouse beneficiary of a QTIP trust.5 Thus, the transaction cannot be considered involving offsetting transfers for consideration within the meaning of Rev. Rul. 69-505.

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In Rev. Rul. 98-8, 1998-1 C.B. 541, the surviving spouse purchased from the trust remainderman the remainder interest in a QTIP trust by issuing a promissory note equal to the actuarial value of the remainder interest to the remainderman. As a result of the purchase, the trust terminated under its terms and the entire corpus was transferred to the surviving spouse. The surviving spouse then used the proceeds to pay the remainderman the value of the remainder interest. The revenue ruling concludes that the purchase of the remainder interest, which is analogous to a commutation of the QTIP trust, is treated as a taxable disposition by the surviving spouse of the qualifying income interest, resulting in a gift of the value of the remainder interest under § 2519. Citing to *Wemyss*, the revenue ruling explains that the receipt of the remainder interest cannot increase the donor’s taxable estate because it is already subject to inclusion in the surviving spouse’s taxable estate under § 2044. Accordingly, the surviving spouse’s receipt of the remainder interest cannot constitute adequate and full consideration under § 2512 for the promissory note transferred. The revenue ruling notes that any other result would subvert the legislative intent and statutory scheme underlying § 2056(b)(7).

In *Estate of Kite v. Commissioner*, T.C. Memo. 2013-43, the surviving spouse was the beneficiary of two QTIP trusts. According to a prearranged plan, the QTIP trusts were terminated and all assets were distributed to the surviving spouse. Two days later, the surviving spouse sold the assets to her three children in exchange for three deferred private annuity agreements under which payments would commence ten years thereafter. In the event that the surviving spouse died within the ten-year period, her annuity interest would terminate and nothing would be payable to her estate. Based on the facts and circumstances, the court found the sale of the assets of the QTIP trusts to the children in exchange for deferred annuities constituted a bona fide sale for adequate and full consideration and treated the annuity transaction as a single integrated transaction for purposes of § 2519. Moreover, the sale of the assets of the QTIP trusts, followed by the payment to the surviving spouse of the proceeds equal to the value of her income interest, was a disposition of her qualifying income interest for purposes of § 2519. In response to petitioner’s post-opinion argument that there was no gift tax deficiency for the § 2519 disposition of the surviving spouse’s qualifying income interest based on the receipt of full and adequate consideration, the court stated,

[S]ection 2519(a) treats the disposition of a qualifying income interest as a deemed transfer of the remainder interest. In other words, “the donee spouse is treated as making a gift under section 2519 of the entire trust less the qualifying income interest” (emphasis added). Sec. 25.2519-1(a), Gift Tax Regs. The term “gift” is not an accident. The remainder interest is a future interest held by the remainderman and not the donee spouse. Accordingly, the donee spouse cannot receive full and adequate consideration, or indeed any consideration, in exchange for the remainder interest. This result is supported by the intent of the marital deduction and the QTIP regime.

*Estate of Kite v. Commissioner*, No. 6772-08 (T.C. Oct. 25, 2013) (order and decision under Tax Court Rule 155). The court ruled that the decedent owed gift tax on the value of the deemed § 2519 gift. *Id*.

Here, the QTIP statutory scheme and legislative history support the view that Rev. Rul. 69-505 has no application and the separate transfers by Spouse and Children cannot be offset by consideration for gift tax purposes. Decedent’s estate received the benefit of deferral of the estate tax liability allocable to the property of Trust 1 as a result of electing QTIP for such property under § 2056(b)(7). Because the commutation effected by Agreement constitutes a taxable disposition by Spouse within the meaning of § 2519(a) (see Issue 1), it marks the end of the deferral of the tax.

Rev. Rul. 98-8 and *Estate of Kite* illustrate that a disposition under § 2519(a) has significant tax consequences, which are appropriate in view of the QTIP statutory scheme and legislative history. Here, because the commutation of Trust 1 results in a disposition of Spouse’s qualifying income interest within the meaning of § 2519(a), Spouse is treated as effectively transferring the remainder interest even though under state property law precepts the remainder interest is held by Children, not Spouse. The taxable transfer by Spouse resulting from the application of § 2519 marks the end of the deferral of estate tax on the Trust 1 property that passed untaxed from Decedent’s estate, and is no longer subject to inclusion in Spouse’s gross estate under § 2044(b)(2). Eliminating the taxable transfer by Spouse based on a deemed reciprocal gift transfer by the remaindermen would allow the value of the remainder of Trust 1 to escape transfer tax under both §§ 2519 and 2044, which would be contrary to the QTIP statutory scheme and legislative history.

Finally, the National Office got around to valuing the two gifts. The spouse’s gift – recall that the spouse received all the property – was valued by subtracting the spouse’s income interest from the full value of the trust property. The children’s gifts were valued based on standard actuarial methods. The CCA states:

Section 25.2519-1(c)(4) provides that the amount treated as a transfer under § 25.2519-1(c)(1) is further reduced by the amount the surviving spouse is entitled to recover under § 2207A(b) (relating to the right to recover gift tax attributable to the remainder interest). Under § 25.2519-1(c)(4), if the donee spouse is entitled to recover gift tax under § 2207A(b), the amount of the gift tax recoverable and the value of the interest treated as transferred under § 2519 are determined by using the same interrelated computation applicable for other transfers in which the transferee assumes the gift tax liability. The gift tax consequences of failing to exercise the right of recovery are determined separately under § 25.2207A-1(b).

Under § 2207A(b) and § 25.2207A-1(a), a surviving spouse treated as transferring an interest in property by reason of § 2519 is entitled to recover from the “person receiving the property” the amount of gift tax attributable to that property. The right of recovery arises at the time the gift tax is actually paid by the surviving spouse subject to § 2519.

In this case, the amount of Spouse’s gift under § 2519 is determined by subtracting the value of Spouse’s qualifying income interest from the fair market value of the trust property as of Date 3, the date of Agreement. Section 2519(a); § 25.2519-1(a). Discretionary principal distributions and the testamentary limited power of appointment are not taken into account. A standard § 7520 income factor can be used to value the qualifying income interest, and thus, the value of Spouse’s qualifying income interest is determined by multiplying the value of the trust property by the income factor of

0.09172.6 Section 25.2512-5(d)(2)(iii); § 25.7520-1. Based on a value of the trust property of $b, the value of Spouse’s qualifying income interest is $e. The amount of Spouse’s gift under § 2519, therefore, is $f (i.e., $b – $e = $f).

To the extent Spouse is entitled to recover gift tax attributable to the remainder interest under § 2207A(b), this amount is reduced, using an interrelated calculation. Note that, under § 25.2207A-1(b), if Spouse waives or otherwise fails to exercise Spouse’s right of recovery, Spouse will be treated as making an additional gift in the amount of the unrecovered tax.7

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Based on the available facts, it is appropriate to value each of Children’s interests as one-half of the actuarial present value of the remainder interest, adjusting as necessary for the restrictions on the beneficial interests. The determination takes into account that the possibility of principal invasion was so remote as to be negligible, given that the combined value of the property held by Trust 1 was $b at the time of commutation and, thus, annual income of Trust 1 would have been substantial and likely sufficient for Spouse’s health, maintenance, and support, even if Spouse’s accustomed manner of living were extravagant.8 Further, the determination takes into account, based on all the facts and circumstances, that the testamentary limited power of appointment would be appropriately treated as having no measurable effect on the values of these interests.

Accordingly, based on the available facts, we conclude that the actuarial value of Children’s proportionate shares of the remainder interest is properly determined under § 7520, using a standard remainder factor. Thus, the value of each child’s remainder interest under § 7520 is determined by multiplying the value of the trust property by the remainder factor of 0.908289 then dividing the product by 2. Section 25.2512-5(d)(2)(ii); § 25.7520-1. Based on a value of the trust property of $b, the fair market value of each child’s gift, therefore, is $g (i.e., ($b x 0.90828) ÷ 2 = $g).

Footnote 8 notes that the spouse must not have needed principal distributions because the spouse sold most of the assets received “immediately after Spouse received it in exchange for promissory notes that did not provide for the payment of principal until a date after Spouse’s probable life expectancy.”

In PLR 202116001 a QTIP (“Qualified Trust”) was divided and the spouse released an income right over part of the trust. The ruling describes what happened as follows:

On Date 1, Trustee divided Qualified Trust into two trusts, Qualified Trust-A and Continuing Qualified Trust, both with terms and provisions identical to those set forth in Qualified Trust. Trustee placed $x in cash and marketable securities into Qualified Trust-A and retained all other assets in Continuing Qualified Trust. The assets retained in Continuing Trust are income producing such that Spouse retains the enjoyment of the assets. On Date 2, Trustee and the beneficiaries of Qualified Trust-A petitioned Court for entry of an order with respect to Qualified Trust-A. On Date 3, finding that a continuation of Qualified Trust-A unchanged would defeat or substantially impair its purposes, Court entered Order. Order modifies the terms and provisions of Qualified Trust-A.

Article V of Qualified Trust-A, as modified by Order, provides that Qualified Trust-A shall terminate upon the death of the last surviving income beneficiary. However, at any time, including prior to Spouse’s death*,* Qualified Trust-A may be terminated as to a beneficiary’s interest and any part of the trust property representing her interest may be distributed to that beneficiary if the trustee considers such distribution to be in the best interests of the beneficiary, considering the demonstrated ability of the beneficiary to handle money and property wisely, her judgment, prudence and discretion, and any other factors the trustee may consider relevant. The trustee may exercise the power of termination even if the beneficiary is restrained from alienating her interest.

Article III, section 3.1, as modified by Order, provides that the original and principal beneficiaries of Qualified Trust-A shall become the income beneficiaries in proportion to their interests in the principal. Section 7.2, allowing the trustee to make distributions to Spouse for her health, education, maintenance and support, is deleted in its entirety. Order further provides that, the terms and conditions of Qualified Trust-A shall be interpreted and applied as if Spouse had died on the date Order is entered, and that Trustees shall continue to be the trustee of Qualified Trust-A and Continuing Qualified Trust. Although Order is effective on Date 3, it is expressly conditioned on receipt of favorable rulings from the Internal Revenue Service prior to Date 4.

Because the trust continued even after the income interest was given up, there was no gift form the remainder beneficiaries. However, the gift by the spouse was described like this:

In the present case, following the division of Qualified Trust on Date 1, the trusts resulting from the division, Qualified Trust-A and Continuing Qualified Trust, had terms and provisions identical to those set forth in Qualified Trust. Thus, the division of Qualified Trust did not change the beneficial interests of Spouse, Daughter 1 or Daughter 2 in the property originally held in Qualified Trust. Accordingly, based on the facts submitted and representations made, we rule that the division of Qualified Trust on Date 1 did not cause the assets remaining in Qualified Trust after the division (referred to as Continuing Qualified Trust) to be subject to the United States Gift Tax pursuant to § 2519 or 2511.

Order, however, modifies the terms of Qualified Trust-A to change the beneficial interests of Spouse, Daughter 1, and Daughter 2 in the property of Qualified Trust-A. Article V of Qualified Trust-A, which continues to provide that Qualified Trust-A shall terminate upon the death of the last surviving income beneficiary, is modified to provide that at any time, including prior to Spouse’s death, Qualified Trust-A may be terminated as to a beneficiary’s interest. In other words, Order terminates Spouse’s income interest as of Date 3. The term “disposition” as used in § 2519, applies broadly to circumstances in which the surviving spouse’s right to receive the income is relinquished or otherwise terminated, by whatever means. See H. Rep. No. 97-201, at 161 (1981). The property in Qualified Trust-A is a portion of the property originally held by Qualified Trust with respect to which Decedent’s estate was allowed a deduction under § 2056(b)(7). Thus, for purposes of § 2519, the entry of Order on Date 3 resulted in a disposition of a qualifying income interest for life in Qualified Trust-A.

Accordingly, based on the facts submitted and representations made, we rule that Spouse is deemed to have made a transfer of all of the property in Qualified Trust-A under § 2519, other than the value of her qualifying income interest, and Spouse is deemed to have made a transfer of her qualifying income interest in Qualified Trust-A under § 2511, on Date 3 upon entry of Order approving modifications by which the income interest of Spouse in Qualified Trust-A is terminated and distributions from Qualified Trust-A are permitted to be made prior to death of Spouse.

A QTIP election is at root a “deal” between the surviving spouse and the government. The government allows a marital deduction and the surviving spouse agrees that all of the enjoyment and value of the property as to which the election is made will flow through the hands of the surviving spouse. The “deal” is necessary because a QTIP trust often is designed without any other power in the surviving spouse which would cause estate tax inclusion. Accordingly, if the surviving spouse gives up any of the income interest in QTIP property, the surviving spouse is deemed to have made a gift of the entire value of that QTIP property (that would not have had to be the rule; the surviving spouse could have been deemed to have made a gift of that portion of the income, but such a determination is complicated and uncertain, thus a strict “penalty” rule was imposed by statute). However, concluding that a “transfer” of a remainder by the children has occurred and is a gift creates double-taxation of the same QTIP property. Had there been no QTIP election the government’s approach would have been more sensible: the spouse had an income interest, the children a remainder interest, the children allowed all the trust property to be distributed to the spouse which must have been a gift of the remainder interest.

# SECTIONS 2501 TO 2524 – GIFTS

## **Unusual Assignment Clause Produced A Gift**

. Nelson v. Commissioner, T.C. Memo. 2020-81, involved the transfer of units in a limited partnership, Longspar, to a trust in 2008. One transfer was a gift, the other a sale for a note. The transfers were by assignment as follows:

Mrs. Nelson made two transfers of limited partner interests in Longspar to the Trust. The first transfer was a gift on December 31, 2008. The Memorandum of Gift and Assignment of Limited Partner Interest (memorandum of gift) provides:

[Mrs. Nelson] desires to make a gift and to assign to \* \* \* [the Trust] her right, title, and interest in a limited partner interest having a fair market value of TWO MILLION NINETY-SIX THOUSAND AND NO/100THS DOLLARS ($2,096,000.00) as of December 31, 2008 \* \* \*, as determined by a qualified appraiser within ninety (90) days of the effective date of this Assignment.

Petitioners structured the second transfer, on January 2, 2009, as a sale. The Memorandum of Sale and Assignment of Limited Partner Interest (memorandum of sale) provides:

[Mrs. Nelson] desires to sell and assign to \* \* \* [the Trust] her right, title, and interest in a limited partner interest having a fair market value of TWENTY MILLION AND NO/100THS DOLLARS ($20,000,000.00) as of January 2, 2009 \* \* \*, as determined by a qualified appraiser within one hundred eighty (180) days of the effective date of this Assignment \* \* \*.

Neither the memorandum of gift nor the memorandum of sale (collectively transfer instruments) contains clauses defining fair market value or subjecting the limited partner interests to reallocation after the valuation date. In connection with the second transfer, the Trust executed a promissory note for $20 million (note). Mr. Nelson, as trustee, signed the note on behalf of the Trust. The note provides for 2.06% interest on unpaid principal and 10% interest on matured, unpaid amounts, compounded annually, and is secured by the limited partner interest that was sold. Annual interest payments on the note were due to Mrs. Nelson through the end of 2017.

Appraisals were completed and 6.14% and 58.65% of the Longspar units were transferred. Upon audit, the IRS increased the values of the units transferred. The question for the court was what was transferred:

The parties agree that the transfers were complete once Mrs. Nelson executed the transfer instruments parting with dominion and control over the interests. See Burnet v. Guggenheim, 288 U.S. 280, 286 (1933); Carrington v. Commissioner, 476 F.2d 704 (5th Cir. 1973), aff’g T.C. Memo. 1971-222; Estate of Metzger v. Commissioner, 100 T.C. 204, 208 (1993), aff’d, 38 F.3d 118 (4th Cir. 1994); sec. 25.2511-2(b), Gift Tax Regs. But they disagree over whether Mrs. Nelson transferred Longspar limited partner interests of $2,096,000 and $20 million, as petitioners contend, or percentage interests of 6.14% and 58.65%, as respondent contends.

We look to the transfer documents rather than subsequent events to decide the amount of property given away by a taxpayer in a completed gift. See Estate of Petter v. Commissioner, T.C. Memo. 2009-280, 2009 WL 4598137, at \*12 (citing Succession of McCord v. Commissioner, 461 F.3d 614, 627 (5th Cir. 2006), rev’g and remanding 120 T.C. 358 (2003)), aff’d, 653 F.3d 1012 (9th Cir. 2011); see also Commissioner v. Procter, 142 F.2d 824 (4th Cir. 1944) (disregarding the subsequent reallocation of property to the donor via a saving clause as contrary to public policy), rev’g and remanding a Memorandum Opinion of this Court. Petitioners argue that the transfer instruments show that Mrs. Nelson transferred specific dollar amounts, not fixed percentages, citing a series of cases that have respected formula clauses as transferring fixed dollar amounts of ownership interests. In each of those cases we respected the terms of the formula, even though the percentage amount was not known until fair market value was subsequently determined, because the dollar amount was known. Wandry v. Commissioner, T.C. Memo. 2012-88, 2012 WL 998483, at \*4; Hendrix v. Commissioner, T.C. Memo. 2011-133, 2011 WL 2457401, at \*5-\*9; Estate of Petter v. Commissioner, 2009 WL 4598137, at \*11-\*16.

Saving clauses have been treated differently. As we explained in Estate of Petter and Wandry, courts have rejected saving clauses because they relied on conditions subsequent to adjust the gifts or transfers so the size of the transfer (as measured either in dollar amount or percentage) could not be known. Thus, for example, in Commissioner v. Procter, 142 F.2d at 827, the Court of Appeals for the Fourth Circuit rejected a clause adjusting part of a gift to “automatically be deemed not to be included in the conveyance in trust hereunder and shall remain the sole property of \* \* \* [the taxpayer]” because the adjustment would be triggered only by a “final judgment or order of a competent federal court of last resort that any part of the transfer \* \* \* is subject to gift tax.”

In Succession of McCord v. Commissioner, 461 F.3d at 618, the Court of Appeals for the Fifth Circuit upheld a gift of an interest in a partnership expressed as “a dollar amount of fair market value in interest” reduced by a transfer tax obligation rather than a percentage interest that was determined in agreements subsequent to the gift. It held that “a gift is valued as of the date that it is complete; the flip side of that maxim is that subsequent occurrences are off limits.” Id. at 626. The formula clause in the initial transfer document did not include qualifying language that fair market value was to be “as finally determined for [Federal gift] tax purposes,” but the court did not find that omission fatal because the value of the gift was ascertainable as of the date it was complete. Id. at 627.

Petitioners argue that we should construe the transfer clauses here as more akin to the formula clauses that were upheld in Succession of McCord, Estate of Petter, and Wandry, that is, read them as transferring dollar amounts rather than percentages. However, as part of their argument, they cite evidence of their intent, which includes their settlement discussions with IRS Appeals and subsequent adjustments to reflect changes in valuation to reflect those discussions. Of course, as in Succession of McCord, we look to the terms of the transfer instruments and not to the parties’ later actions except to the extent that we conclude the terms are ambiguous and their actions reveal their understanding of those terms. Id. at 627- 628.

Therefore, to decide whether the transfers were of fixed dollar amounts or fixed percentages, we start with the clauses themselves, rather than the parties’ subsequent actions. The gift is expressed in the memorandum of gift as a “limited partner interest having a fair market value of TWO MILLION NINETY-SIX THOUSAND AND NO/100THS DOLLARS ($2,096,000.00) as of December 31, 2008 \* \* \*, as determined by a qualified appraiser within ninety (90) days of the effective date of this Assignment.” Similarly, the sale is expressed in the memorandum of sale as a “limited partner interest having a fair market value of TWENTY MILLION AND NO/100THS DOLLARS ($20,000,000.00) as of January 2, 2009 \* \* \*, as determined by a qualified appraiser within one hundred eighty (180) days of the effective date of this Assignment.”

The transferred interests thus are expressed in the transfer instruments as an interest having a fair market value of a specified amount as determined by an appraiser within a fixed period. The clauses hang on the determination by an appraiser within a fixed period; value is not qualified further, for example, as that determined for Federal estate tax purposes. See, e.g., Estate of Christiansen v. Commissioner, 130 T.C. 1, 14-18 (2008) (upholding gift clause providing fair market value “as such value is finally determined for federal estate tax purposes”), aff’d, 586 F.3d 1061 (8th Cir. 2009); Estate of Petter v. Commissioner, 2009 WL 4598137, at \*11-\*16 (upholding gift clause transferring the number of units of a limited liability company “that equals one-half the minimum \* \* \* dollar amount that can pass free of federal gift tax by reason of Transferor’s applicable exclusion amount” along with a clause providing for an adjustment to the number of units if the value “is finally determined for federal gift tax purposes to exceed the amount described” in the first clause).

Unlike the clause in Succession of McCord, “fair market value” here already is expressly qualified. By urging us to interpret the operative terms in the transfer instruments as transferring dollar values of the limited partner interests on the bases of fair market value as later determined for Federal gift and estate tax purposes, petitioners ask us, in effect, to ignore “qualified appraiser \* \* \* [here, Mr. Shrode] within \* \* \* [a fixed period]” and replace it with “for federal gift and estate tax purposes.” While they may have intended this, they did not write this. They are bound by what they wrote at the time. As the texts of the clauses required the determination of an appraiser within a fixed period to ascertain the interests being transferred, we conclude that Mrs. Nelson transferred 6.14% and 58.35% of limited partner interests in Longspar to the Trust as was determined by Mr. Shrode within a fixed period.

Longspar itself owned interests in a closely-held company, “Stacked” discounts were allowed, summarized by the court as follows:

First, Mrs. Nelson transferred 6.14% and 58.65% Longspar limited partner interests to the Trust. Next, discounts of 15% for lack of control and 30% for lack of marketability should apply to the valuation of WEC common stock, resulting in a fair market value of $912 per share. Therefore, the controlling, marketable value of Longspar is $60,729,361. Discounts of 5% for lack of control and 28% for lack of marketability should apply to calculate the fair market value of a Longspar limited partnership interest. As a result, a 1% Longspar limited partner interest has a fair market value of $411,235 and the 6.14% and 58.65% Longspar limited partner interests Mrs. Nelson transferred to the Trust have fair market values of $2,524,983 and $24,118,933, respectively.

## **Gifts vs. Loans vs. Loans Incapable of Repayment**

. At issue in Estate of Bolles, T.C. Memo. 2020-71, was whether various transfers, mother to son, were gifts, loans, or, as it turns out, loans that couldn’t be repaid. The case suggests that taxpayers should argue with the IRS if they can prove a change in circumstances between the time of an unpaid loan and the time of the lender’s death. The court’s conclusion is as follows:

Finally, we address the issue of whether the advances were loans or gifts. Both parties rely on the analysis of Miller v. Commissioner, T.C. Memo. 1996-3, aff’d, 113 F.3d 1241 (9th Cir. 1997), for the traditional factors used to decide whether an advance is a loan or a gift. Those factors are explained as follows: (1) there was a promissory note or other evidence of indebtedness, (2) interest was charged, (3) there was security or collateral, (4) there was a fixed maturity date, (5) a demand for repayment was made, (6) actual repayment was made, (7) the transferee had the ability to repay, (8) records maintained by the transferor and/or the transferee reflect the transaction as a loan, and (9) the manner in which the transaction was reported for Federal tax purposes is consistent with a loan.

These factors are not exclusive. See, e.g., Estate of Maxwell v. Commissioner, 98 T.C. 594 (1992), aff’d, 3 F.3d 591 (2d Cir. 1993). In the case of a family loan, it is a longstanding principle that an actual expectation of repayment and an intent to enforce the debt are critical to sustaining the tax characterization of the transaction as a loan. Estate of Van Anda v. Commissioner, 12 T.C. 1158, 1162 (1949), aff’d per curiam, 192 F.2d 391 (2d Cir. 1951).

While Mary recorded the advances to Peter as loans and kept track of interest, there were no loan agreements or attempts to force repayment. Respondent focuses on the lack of security for the loans to Peter. We agree that the reasonable possibility of repayment is an objective measure of Mary’s intent. The estate maintains that during her life Mary always considered these advances as loans. We cannot reconcile this argument with the deterioration of Peter’s financial situation and the ultimate failure of his practice in San Francisco and later in Las Vegas.

Peter’s creativity as an architect and his ability to attract clients likely impressed Mary. We find she expected him to make a success of the practice as his father had, and she was slow to lose that expectation. However, it is clear she realized he was very unlikely to repay her loans by October 27, 1989, when her trust provided for a specific block of Peter’s receipt of assets at the time of her death. Accordingly, in 1990 the “loans” lost that characterization for tax purposes and became advances on Peter’s inheritance from Mary. In conclusion, we find the advances to Peter were loans through 1989 but after that were gifts. We have considered whether she forgave any of the prior loans in 1989, but we find that she did not forgive the loans but rather accepted they could not be repaid on the basis of Peter’s financial distress.

For the opinion to be helpful requires close attention to the facts:

A loving mother of her five children, Mary was determined to provide her assets to her children equally. Her practice was to keep a personal record of her advances and occasional repayments for each child. On the basis of her original intent and the advice of her tax counsel, she treated the advances as loans. She forgave the “debt” account of each child every year on the basis of the gift tax exemption amount. Her practice would have been noncontroversial but for the substantial funds she advanced to Peter.

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Peter was the oldest of their five children. He graduated from college with a degree in architecture in 1965. On the basis of his academic achievements and his father’s reputation as an architect in San Francisco, Peter’s professional career showed great promise. He began his career in Boston. He took over his father’s architecture practice in San Francisco in the early 1970s and enjoyed some early success in attracting clients. Peter expanded the practice through the 1970s into the early 1980s; but despite his salesmanship he began to have financial difficulties largely because his expectations exceeded realistic results. By 1983 Peter’s practice was not current on its bills. In July 1983 Peter, as president of Bolles Associates and Peter B. Bolles, P.A., entered into an agreement with the Bolles Trust to use trust property as security for $600,000 in bank loans. The agreement also reflects that the Bolles Trust was owed $159,828 in back rent by Peter’s practice. Within a year Peter had failed to meet the obligations of the agreement, and the Trust was ultimately held liable for the $600,000. Mary had contemporaneous knowledge of these events.

Between 1985 and 2007 Mary transferred $1,063,333 to or for Peter’s benefit (directly to him, to his accounts, paying other of his debts). Peter made no payments after 1988. In Mary’s estate plan, she adjusted for the transfers, with interest (using the AFR). The IRS argument was that either Mary made gifts or a note should be in her estate:

The calculations found in article five of the First Amendment describe the manner in which advances, described as loans, are to be taken into account in dividing the trust assets among decedent’s children upon her death. In essence, under subparagraph (b), the value of the trust assets after allowance for expenses such as estate tax is divided equally; however, each child’s share is reduced, and that amount redistributed pro rata among the other beneficiaries, by the amount of the child’s outstanding loans, if any, plus accrued interest.

The explanation of adjustments to the notice of deficiency states:

I. Schedule C, Items 2 and 3

It is determined that the fair market value of the Promissory Note and receivable due from Peter P. Bolles under IRC section 2031 is $1,063,333 instead of zero as reported and that interest on the Promissory Note and receivable is includible in the gross estate under IRC section 2033 in the amount of $1,165,778. Therefore, the value of the gross estate is increased by $2,229,111.

II. Adjusted Taxable Gifts

In the event it is determined that the fair market value under IRC section 2031 of the Promissory Note and receivable from Peter Bolles and interest on the Promissory Note and receivables is zero then it is determined that Mary P. Bolles transferred property to Peter Bolles during her life such that “adjusted taxable gifts” in the amount of $1,063,333 is included in computing taxpayer’s estate tax liability under IRC section 2001(b).

This is an interesting situation but one that is difficult but not impossible to replicate for planning purposes. Suppose a parent loans money to a child to pay the child’s expenses during, say medical school; then the child goes into a line of medical work that cannot support repayment. Perhaps in such instance a no gift, no loan position could be sustained, but most families would not plan for such.

# SECTION 2518 – DISCLAIMERS

# SECTIONS 2601-2654 - GENERATION-SKIPPING TRANSFER TAX

## **Modification of GST Grandfathered Trust Allowed Where Property Vested in Same Generation As Before Modification**

. PLR 202011001 states:

In this case, Trust A was irrevocable prior to September 25, 1985. The amended trust agreement provides for outright distribution to the beneficiaries upon the termination of Trust A and the Trust A Successor Trusts, 21 years after the death of Son. Under the proposed modification of the trust agreement, any share upon the termination of Trust A and the Trust A Successor Trusts distributable to a beneficiary who is under the age of b, will be held in a continuing trust for that continuing beneficiary. Each continuing beneficiary will have a testamentary general power of appointment with respect to the property. Under [§ 2041(a)(2)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS2041&originatingDoc=I3ba2cb7f652911ea9eddce4ad7b4b097&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.DocLink)#co_pp_d86d0000be040), the continuing beneficiary's trust property will be includible in his or her estate at his or her death. Further, each continuing beneficiary will be treated as the transferor of the trust corpus for GST tax purposes under [§ 2652(a)(1)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=26USCAS2652&originatingDoc=I3ba2cb7f652911ea9eddce4ad7b4b097&refType=RB&originationContext=document&transitionType=DocumentItem&contextData=(sc.DocLink)#co_pp_7b9b000044381). The proposed modification will not result in a shift of any beneficial interest in any beneficiary who occupies a generation lower than the persons holding the beneficial interests. Further, the proposed modification in further trust will not extend the time for vesting of any beneficial interest in any trust. Accordingly, based on the facts presented and the representations made, we rule that the proposed modification will not cause Trust A or the Trust A Successor Trusts to lose their exemption from the GST tax of chapter 13.

The modifications appeared to have the purpose of affecting distribution to son. The ruling is one of a series.

# SECTIONS 2701-2704 - SPECIAL VALUATION RULES

## **How Might The Doctrine Of Merger Be Used With A GRAT?**

Because a trust is created by separating legal and equitable title to property, merging legal and equitable title to property in one person will, in general, cause the trust to terminate. The doctrine of merger is incorporated in section 402(a)(5) of the UTC, the comment to which states:

Subsection (a)(5) addresses the doctrine of merger, which, as traditionally stated, provides that a trust is not created if the settlor is the sole trustee and sole beneficiary of all beneficial interests. The doctrine of merger has been inappropriately applied by the courts in some jurisdictions to invalidate self-declarations of trust in which the settlor is the sole life beneficiary but other persons are designated as beneficiaries of the remainder. The doctrine of merger is properly applicable only if all beneficial interests, both life interests and remainders, are vested in the same person, whether in the settlor or someone else. An example of a trust to which the doctrine of merger would apply is a trust of which the settlor is sole trustee, sole beneficiary for life, and with the remainder payable to the settlor’s probate estate.

The Restatement (Third) of Trusts § 69, Comment b, states that “[i]f, by operation of law, the legal title to the trust property passes to the beneficiary who has the entire beneficial interest, merger occurs, the trust terminates, and the beneficiary holds the property free of trust. Where the life interest and remainder interest is held by two beneficiaries who are also the only co-trustees, whether merger occurs in favor of the two beneficiaries is uncertain. See Scott and Ascher on Trusts § 11.2.5.

Suppose the grantor and the remainder beneficiaries contribute their respective interests to an LLC in exchange for membership interests that are proportionate to the interests of each such that the grantor receives an interest equal in value to the amount that would be included in the grantor estate if she died at that moment. The LLC would have all the beneficial interests in the GRAT property. If the LLC could become trustee of the GRAT then the doctrine of merger ought to apply. May an LLC serve as trustee? Under the UTC, for example, there is no definition of trustee but there are broad references to “persons” serving as trustee and the definition of person includes entities like an LLC. Some states may impose other limitations. In PLR 201928005, dealing with merger in the context of a GRAT, the IRS notes a state law requirement that a trustee may terminate a CLAT where the annuity and remainder are held by one beneficiary (and concludes the trustee doing so will not cause gain or loss recognition).

Where an LLC cannot serve as trustee, if the LLC managers serve as trustees is that sufficient? The answer is uncertain. The LLC managers are not the LLC.

Would a merger into an LLC be a taxable event for income tax purposes? The answer would seem to be no. Similarly, because the grantor receives an LLC interest having a value equal to what would be in the grantor’s estate if the grantor died at that moment concerns like those raised in CCA 201745012 arguably are avoided.

## **GRAT Inclusion**

. Treas. Reg. §20.2036-1(c)(2)(i) applies section 2036 to a GRAT. When the grantor dies during the GRAT term, an amount of the GRAT is included in the grantor’s estate which is sufficient to produce the annuity using the section 720 rate then in effect (with special rules for annuities, that change during the term). As a practical matter, absent a substantial increase in the section 7520 rate between the date of the GRAT and the grantor’s death, an extraordinary appreciation, all of a GRAT is included in the Grantor’s estate at death. An exception is for GRATs with long terms, perhaps as long as 99 years, because the annuity required to zero out over such a long-term is very low, as discussed below.

In Badgley v. United States, 121 A.F.T.R.2d 2018-1816 (N.D. Ca. 2018) the taxpayer challenged the regulation where the GRAT term was 15 years. The taxpayer lost. The opinion states:

Plaintiff contends that the Court should disregard the Regulation as an unreasonable interpretation of section 2036 as applied to Patricia’s GRAT. *See* Pl. Mot. at 24 (citing *Prof’l Equities v. Commissioner*, 89 T.C. 165 (1987)). Defendant argues that the Regulation is a reasonable interpretation of section 2036 and valid under *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984). Plaintiff does not expressly dispute that *Chevron* applies; instead, Plaintiff claims that the Regulation is interpretive and thus given less deference as compared to a legislative rule. See Pl. Opp. at 19.

The Court applies *Chevron*’s two-step framework. *See Mayo Found. for Med. Educ. & Research v. United States*, 562 U.S. 44, 52 (2011). At *Chevron* step one, the Court asks “whether Congress has directly addressed the precise question at issue.” *Id*. (quotation omitted). The parties agree that section 2036 does not expressly address whether annuity payments constitute some possession, enjoyment, or right to income from the transferred property. Def. Mot. at 14; Pl. Mot. at 19. So the Court proceeds to step two. At that step, the Court “may not disturb an agency rule unless it is arbitrary or capricious in substance, or manifestly contrary to the statute.” *Mayo Found. for Med. Educ.*, 562 U.S.at 53 (quotation omitted).

The Court concludes that the Regulation is reasonable, and valid under *Chevron*. In drafting the Regulation, the IRS and Treasury Department relied principally on the above discussed binding authorities, including *Church’s, Hallock, and Spiegel’s*. *See* Grantor Retained Interest Trusts—Application of Sections 2036 and 2039, T.D. 9414, 73 Fed. Reg. 40173-01 (July 14, 2008) at 40174. Those cases support Defendant’s view of section 2036, which parallels the Regulation’s interpretation of that section. The IRS and Treasury Department also drew on section 2036’s legislative history to devise the Regulation, observing that Congress amended section 811(c) to include interests retained for a term of years. *Id*. (citing H.R. Rep. no. 81-1412 at 9 (1949)). Though Plaintiff cites legislative history for the opposite conclusion, Plaintiff does not explain why that history supports the Regulation. *See* Pl. Opp. at 20.

Overturning a final regulation is difficult. Here the regulation was designed to be anti-taxpayer. Inclusion with one payment to go is calculated the same as on day 2 of the GRAT. The taxpayer appealed arguing that an annuity is not a retained right to income or use, and the valuation approach of the regulations should be thrown out, but the appeal was denied by the Ninth Circuit. Badgley v. United States, 957 F.3d 969 (9th Cir. 2020). The opinion states:

The fact that § 2036(a)(1) does not include the term “annuity” does not exclude annuities from its ambit. This is consistent with the decisions of the Supreme Court and our sibling circuits, which have concluded that interests such as reversionary interests, the power of appointment, and rent— also not expressly listed in § 2036(a)—nevertheless fall into one of the three categories. *See, e.g., Estate of Spiegel v. Comm’r*, 335 U.S. 701, 705 (1949) (potential reversionary interest in property is possession or enjoyment); *Fid.-Phila. Tr. Co. v. Rothensies*, 324 U.S. 108, 111 (1945) (beneficiaries’ estates “took effect in enjoyment” only at transferor’s death because she held power of appointment); *Estate of McNichol*, 265 F.2d at 671 (rent from property is enjoyment). As far back as the 1940s, the Supreme Court rejected the proposition that taxpayers could “escape the force of this section by hiding behind the legal niceties contained in devices and forms created by conveyances.” *Church’s Estate*, 335 U.S. at 646 (quotation omitted); *see also Fid.- Phila.*, 324 U.S. at 111 (“The application of this tax does not depend upon elusive and subtle casuistries.” (quotation omitted)). We reject Badgley’s argument that because § 2036(a)(1) does not expressly mention annuities, the full value of Decedent’s GRAT cannot be included in the gross estate.

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In *Commissioner v. Clise*, 122 F.2d 998 (9th Cir. 1941), involving annuity contracts outside of the trust context, we concluded that when a grantor retained the “economic benefit” of annuity payments, she retained enjoyment of the property. *Id.* at 999, 1003–04. Because the annuities went to Clise for her lifetime and to a designated second annuitant upon her death, “[t]he practical effect of the annuity contracts was to reserve to [her] the enjoyment of the property transferred and to postpone the fruition of the economic benefits thereof to the second annuitants until her death.” *Id.* at 1004; *see also Forster v. Sauber*, 249 F.2d 379, 380 (7th Cir. 1957) (holding retained annuity includable in gross estate because “grantor has retained the economic enjoyment of the contracts for life”); *Mearkle’s Estate v. Comm’r*, 129 F.2d 386, 388 (3d Cir. 1942) (holding annuity contracts includable because their practical effect was “to reserve to the annuitant the enjoyment of the property transferred and to postpone the fruition of the economic benefits to the second annuitant until after the death of the first”). We conclude that when a grantor derives substantial present economic benefit from property, she retains the enjoyment of the property for purposes of § 2036(a)(1).5 As in *Clise*, Decedent’s annuity was a “substantial present economic benefit,” requiring inclusion of the GRAT’s date of death value in her estate. She received $302,259 per year for fifteen years through the annuity. Moreover, because the partnership was the only property placed in the GRAT, the annuity stemmed from that property interest. As “something of value enjoyed by her,” *Bayliss v. United States*, 326 F.2d 458, 461 (4th Cir. 1964), the annuity reserved to Decedent the enjoyment of the partnership interest during her lifetime. And because Decedent died before the termination of the GRAT, the property was not transferred to its beneficiaries before her death—and remained tied to her by the string she created.

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Badgley also challenges 26 C.F.R. § 20.2036-1(c)(2), which includes the formula the IRS uses to calculate the portion of the property includable under § 2036(a). The regulation interprets § 2036(a) to provide that GRATs are includable in a grantor’s gross estate because they are sufficiently tied to the grantor.7 Badgley’s argument regarding the formula is limited to two sentences and two footnotes, without a single citation to legal authority. As we have previously held, arguments presented in such a cursory manner are waived. Federal Rule of Appellate Procedure 28(a)(8)(A) requires an appellant’s opening brief to contain the “appellant’s contentions and the reasons for them, with citations to the authorities and parts of the record on which the appellant relies.” *Id*. “Arguments made in passing and not supported by citations to the record or to case authority are generally deemed waived.” *United States v. Graf*, 610 F.3d 1148, 1166 (9th Cir. 2010).

Suppose the grantor of the GRAT is unlikely to survive the term. A remainder interest purchase strategy was tried in CCA 201745012 which the IRS described as follows:

ISSUES

(1) Whether the remainder interest in transferred property in which the donor has retained an annuity replenishes the donor’s taxable estate so as to constitute adequate and full consideration in money or money’s worth for gift tax purposes where the purchase of the remainder occurs on the donor’s deathbed during the term of the annuity.

(2) Whether a note given in exchange for property that does not constitute adequate and full consideration in money or money’s worth for gift tax purposes is deductible as a claim against the estate.

CONCLUSIONS

(1) Where the purchase of the remainder occurs on the donor’s deathbed during the term of the annuity, the remainder does not replenish the donor’s taxable estate. Accordingly, the remainder does not constitute adequate and full consideration in money or money’s worth for gift tax purposes. Merrill v. Fahs, 324 U.S. 308 (1945).

(2) A note given in exchange for property that does not constitute adequate and full consideration in money or money’s worth for gift tax purposes is not deductible as a claim against the estate.

The purchase occurred the day before the grantor died. The essence of the replenishment argument was outlined by the IRS:

In Commissioner v. Wemyss, 324 U.S. 303 (1945), the Supreme Court considered the meaning of the term “adequate and full consideration in money or money’s worth” for gift tax purposes. There, the donor transferred assets to his fiancé to compensate her for the loss of an income interest that would terminate upon her marriage to him. There was no dispute that both a promise of marriage and detriment to a contracting party constituted valuable consideration for purposes of the law of contracts. The Tax Court had held that if the promise of marriage was the consideration, it was not one reducible to a money value and if the fiancé’s loss of the income interest was the consideration, it did not constitute consideration in the hands of the donor.

If we are to isolate as an independently reviewable question of law the view of the Tax Court that money consideration must benefit the donor to relieve a transfer by him from being a gift, we think the Tax Court was correct. . . . The section taxing as gifts transfers that are not made for ‘adequate and full (money) consideration’ aims to reach those transfers which are withdrawn from the donor’s estate. To allow detriment to the donee to satisfy the requirement of ‘adequate and full consideration’ would violate the purpose of the statute and open wide the door for evasion of the gift tax.

Wemyss, 324 U.S. at 307-08. In other words, valuable contractual consideration in the hands of the donor is not sufficient; adequate and full consideration is that which replenishes, or augments, the donor’s taxable estate.

Wemyss had a companion case, Merrill v. Fahs, 324 U.S. 308 (1945), which was also a gift tax case. Merrill and its predecessors likewise involved situations where A transferred property to B, A’s fiancé or spouse, in exchange for B’s relinquishment of marital rights in A’s remaining property. Both Wemyss and Merrill have come to stand for the general proposition that “adequate and full consideration in money or money’s worth” for gift tax purposes is that which replenishes, or augments, the donor’s taxable estate. See Steinberg v. Commissioner, 141 T.C. 258, 266 (2013) (noting that under the estate depletion theory, a donor receives consideration in money or money’s worth only to the extent that the donor’s estate has been replenished), citing Wemyss, at 307-08, and Randolph E. Paul, Federal Estate and Gift Taxation, para. 16.14, at 1114-15 (1942).1 See also I.R.C. § 2043(b)(1) (“Transfers for Insufficient Consideration”). Thus, B’s relinquishment of marital rights in A’s property will have no effect on the includible value of that property in A’s gross estate. Accordingly, the relinquishment of marital rights cannot replenish a donor’s gross estate for estate tax purposes, and thus cannot constitute adequate and full consideration for gift tax purposes. See also Commissioner v. Bristol, 121 F.2d 129, 136 (1st Cir. 1941).

It is important to keep in mind that in each of the above cases, the relinquishment of the marital rights in the donor’s remaining assets did constitute valuable contractual consideration in the hands of the donor, and did benefit the donor. It enabled the donor to dispose of that property free of the spousal claims of the second marriage. See Merrill v. Fahs, 324 U.S. at 309. For instance, Bristol involved the waiver of spousal claims against a family business that the donor wished to bequeath to the children of his first marriage. Bristol, 121 F.2d at 131. Indeed, in each of these cases, it was the prospective husband’s desire to dispose of his property as he chose that was the basis of the ante-nuptial agreement. This freedom did not constitute adequate and full consideration, however, because it did not augment the husband’s taxable estate.

Here, it cannot be disputed that Donor’s liability on the promissory notes depleted Donor’s taxable estate. However, in the context of a deathbed purchase of a remainder interest in transferred property in which a donor has retained a § 2036 “string,” the receipt of the remainder does not increase the value of the donor’s taxable estate, because the value of the entire property, including that of the remainder, will be includible in the donor’s gross estate pursuant to § 2036(a)(1). Thus, Donor’s receipt of the remainder interests cannot constitute adequate and full consideration within the meaning of § 2512(b). Commissioner v. Wemyss, 324 U.S., at 307-08. Cf. Rev. Rul. 98-8, 1998-1 C.B. 541 (reaching a similar conclusion for gift tax purposes in the context of §§ 2519 and 2044.) Accordingly, Donor has made a completed gift to the beneficiaries of Trust 1 in the amount of the value of the promissory notes transferred to Trust 1.

The CCA repeatedly notes the “deathbed” nature of the transaction. It is unclear if an earlier purchase would have mattered, if at such time the entire GRAT would have been included in the grantor’s estate.

When the section 7520 rate is extremely low, a very long-term GRAT will require extremely low annuity payments to zero-out. For example, a 99 year term GRAT when the 7520 rate is 0.6% requires an annuity of 1.342568% to zero-out. If the 7520 rate thereafter increases to 3% (the April 2019 rate) only 44.75239% of the GRAT assets would be included in the grantor/annuitant’s estate. Suppose a GRAT were terminated at such time by the doctrine of merger; the “replenishment” standard suggested by Wemyss would seem to be satisfied.

# SECTION 6166 — EXTENSION OF TIME TO PAY TAX

# TAX ADMINISTRATION

## Priority Guidance Plan

. 2020-2021 (November 17, 2020).

**PART 1. IMPLEMENTATION OF TAX CUTS AND JOBS ACT (TCJA)**

4. Regulations clarifying the deductibility of certain expenses described in §67(b) and (e) that are incurred by estates and non-grantor trusts. Notice 2018-61 was published on July 30, 2018 and proposed regulations were published on May 11, 2020.

\* \* \*

**PART 3. BURDEN REDUCTION**

4. Regulations under §§ 1014(f) and 6035 regarding basis consistency between estate and person acquiring property from decedent. Proposed and temporary regulations were published on March 4, 2016.

\* \* \* \*

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

**PART 6. GENERAL GUIDANCE**

\* \* \*

**EMPLOYEE BENEFITS**

**A. Retirement Benefits**

3. Guidance implementing changes made by the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act), Division O of the Further Consolidated Appropriations Act, 2020, Pub. L. No. 116-94 (133 Stat. 2534) and section 104 of Division M of the Further Consolidated Appropriations Act, 2020, known as the Bipartisan American Miners Act of 2019 (Miners Act).

• PUBLISHED 08/24/20 in IRB 2020-35 as NOT. 2020-62 (RELEASED 08/06/20).

• PUBLISHED 08/31/20 in IRB 2020-36 as NOT. 2020-60 (RELEASED 08/13/20).

• PUBLISHED 09/14/20 in IRB 2020-38 as REV. PROC. 2020-40 (RELEASED 09/02/20).

• PUBLISHED 09/14/20 in IRB 2020-38 as NOT. 2020-68 (RELEASED 09/02/20).

\* \* \*

6. Regulations under § 401(a)(9) updating life expectancy and distribution tables for purposes of the required minimum distribution rules and addressing certain other issues under section 401(a)(9). Note: Proposed Regulations Issued November 8, 2019.

7. Regulations relating to SECURE Act modifications to certain rules governing §401(k) plans.

\* \* \*

**EXEMPT ORGANIZATIONS**

2. Guidance on circumstances under which an LLC can qualify for recognition under §501(c)(3).

\* \* \*

4. Final regulations on §509(a)(3) supporting organizations. Proposed regulations were published on February 19, 2016.

5. Guidance under §4941 regarding a private foundation's investment in a partnership in which disqualified persons are also partners.

6. Regulations regarding the excise taxes on donor advised funds and fund management.

\* \* \*

**GIFTS AND ESTATES AND TRUSTS**

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

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

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

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

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

**INSURANCE COMPANIES AND PRODUCTS**

1. Final regulations under § 72 on the exchange of property for an annuity contract. Proposed regulations were published on October 18, 2006.

## **No Ruling Positions**

. In Rev. Proc. 2021-3 the IRS provided issues on which it will not rule. Among those are:

(38) Section 170.—Charitable. Etc., Contributions and Gifts.—Whether a charitable contribution deduction under § 170 is allowed for a transfer of an interest in a limited partnership or a limited liability company taxed as a partnership to an organization described in § 170(c).

(39) Section 170.—Charitable, Etc., Contributions and Gifts.—Whether a taxpayer who advances funds to a charitable organization and receives therefor a promissory note may deduct as contributions, in one taxable year or in each of several years, amounts forgiven by the taxpayer in each of several years by endorsement on the note.

(81) Sections 507, 664, 4941, and 4945.—Termination of Private Foundation Status; Charitable Remainder Trusts; Taxes on Self-Dealing; Taxes on Taxable Expenditures.—Issues pertaining to the tax consequences of the termination of a charitable remainder trust (as defined in § 664) before the end of the trust term as defined in the trust's governing instrument in a transaction in which the trust beneficiaries receive their actuarial shares of the value of the trust assets.

(87) Section 641. —Imposition of Tax. —Whether the period of administration or settlement of an estate or a trust (other than a trust described in §664) is reasonable or unduly prolonged.

(88) Section 642(c). —Deduction for Amounts Paid or Permanently Set Aside for a Charitable Purpose. —Allowance of an unlimited deduction for amounts set aside by a trust or estate for charitable purposes when there is a possibility that the corpus of the trust or estate may be invaded.

(89) Section 643(f).—Treatment of multiple trusts.—Whether two or more trusts shall be treated as one trust for purposes of subchapter J of chapter 1.

(90) Section 664. —Charitable Remainder Trusts. —Whether the settlement of a charitable remainder trust upon the termination of the noncharitable interest is made within a reasonable period of time.

(92) Section 671.—Trust Income, Deductions, and Credits Attributable to Grantors and Others as Substantial Owners.—Whether the grantor will be considered the owner of any portion of a trust when (i) substantially all of the trust corpus consists or will consist of insurance policies on the life of the grantor or the grantor's spouse, (ii) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (iii) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, and (iv) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under §§ 673 to 677.

(97) Section 1001.—Determination of Amount of and Recognition of Gain or Loss.—Whether the termination of a charitable remainder trust before the end of the trust term as defined in the trust's governing instrument, in a transaction in which the trust beneficiaries receive their actuarial shares of the value of the trust assets, is treated as a sale or other disposition by the beneficiaries of their interests in the trust.

(111) Section 2055.—Transfers for Public, Charitable, and Religious Uses.— Whether a charitable contribution deduction under § 2055 is allowed for the transfer of an interest in a limited partnership or a limited liability company taxed as a partnership to an organization described in § 2055(a).

(113) Section 2522.—Charitable and Similar Gifts.—Whether a charitable contribution deduction under § 2522 is allowable for a transfer of an interest in a limited partnership or a limited liability company taxed as a partnership to an organization described in § 2522(a).

(114) Section 2601.—Tax Imposed.— Whether a trust exempt from generation- skipping transfer (GST) tax under § 26.260l — l(b)(1), (2), or (3) of the Generation-Skipping Transfer Tax Regulations will retain its GST exempt status when there is a modification of a trust, change in the administration of a trust, or a distribution from a trust in a factual scenario that is similar to a factual scenario set forth in one or more of the examples contained in § 26.2601-1 (b)(4)(i)(E).

(122) Section 4941.—Taxes on Self- Dealing.—Whether transactions during the administration of an estate or trust meet the requirements of the exception to § 4941 set forth in § 53.4941(d)-1(b)(3) of the Private Foundation Excise Tax Regulations, in cases in which a disqualified person issues a promissory note in exchange for property of an estate or trust.

In addition, rulings will “not ordinarily” be issued on the issues below. “Not ordinarily” means that unique and compelling reasons must be demonstrated in order for a ruling to be issued.

(18) Section 170.—Charitable, Etc., Contributions and Gifts.—Whether a taxpayer who transfers property to a charitable organization and thereafter leases back all or a portion of the transferred property may deduct the fair market value of the property transferred and leased back as a charitable contribution.

(39) Section 664.—Charitable Remainder Trusts.—Whether a trust that will calculate the unitrust amount under § 664(d)(3) qualifies as a § 664 charitable remainder trust when a grantor, a trustee, a beneficiary, or a person related or subordinate to a grantor, a trustee, or a beneficiary can control the timing of the trust's receipt of trust income from a partnership or a deferred annuity contract to take advantage of the difference between trust income under § 643(b) and income for Federal income tax purposes for the benefit of the unitrust recipient.

(42) Section 678.—Person Other than Grantor Treated as Substantial Owner.— Whether a person will be treated as the owner of any portion of a trust over which that person has a power to withdraw the trust property (or had such power prior to a release or modification, but retains other powers which would cause that person to be the owner of the trust under § 671 if the person were the grantor), other than a power which would constitute a general power of appointment within the meaning of § 2041. if the trust purchases the property from that person with a note and the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

(49) Sections 2035, 2036, 2037, 2038, and 2042.—Adjustments for Certain Gifts Made Within Three Years of Decedent's Death; Transfers with Retained Life Estate; Transfers Taking Effect at Death; Revocable Transfers; Proceeds of Life Insurance.—Whether trust assets are includible in a trust beneficiary's gross estate under § 2035, 2036. 2037, 2038, or 2042 if the beneficiary sells property (including insurance policies) to the trust or dies within 3 years of selling such property to the trust, and (i) the beneficiary has a power to withdraw the trust property (or had such power prior to a release or modification, but retains other powers which would cause that person to be the owner if the person were the grantor), other than a power which would constitute a general power of appointment within the meaning of § 2041, (ii) the trust purchases the property with a note, and (iii) the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

(52) Section 2501.—Imposition of Tax.—Whether the sale of property (including insurance policies) to a trust by a trust beneficiary will be treated as a gift for purposes of § 2501 if (i) the beneficiary has a power to withdraw the trust property (or had such power prior to a release or modification, but retains other powers which would cause that person to be the owner if the person were the grantor), other than a power which would constitute a general power of appointment within the meaning of § 2041, (ii) the trust purchases the property with a note, and (iii) the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

(53) Section 2503.—Taxable Gifts.— Whether the transfer of property to a trust will be a gift of a present interest in property when (i) the trust corpus consists or will consist substantially of insurance policies on the life of the grantor or the grantor's spouse, (ii) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (iii) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, (iv) the trust beneficiaries have the power to withdraw, on demand, any additional transfers made to the trust, and (v) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under §§ 673 to 677.

(54) Section 2514.—Powers of Appointment.—If the beneficiaries of a trust permit a power of withdrawal to lapse, whether § 2514(e) will be applicable to each beneficiary in regard to the power when (i) the trust corpus consists or will consist substantially of insurance policies on the life of the grantor or the grantor's spouse, (ii) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (iii) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, (iv) the trust beneficiaries have the power to withdraw, on demand, any additional transfers made to the trust, and (v) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under §§ 673 to 677.

(57) Section 2601.—Tax Imposed.— Whether a trust that is exempt from the application of the generation-skipping transfer tax because it was irrevocable on September 25, 1985, will lose its exempt status if the situs of the trust is changed from the United States to a situs outside of the United States.

(58) Section 2702.—Special Valuation Rules in Case of Transfers of Interests in Trusts.—Whether annuity interests are qualified annuity interests under § 2702 if the amount of the annuity payable annually is more than 50 percent of the initial net fair market value of the property transferred to the trust, or if the value of the remainder interest is less than 10 percent of the initial net fair market value of the property transferred to the trust. For purposes of the 10 percent test, the value of the remainder interest is the present value determined under § 7520 of the right to receive the trust corpus at the expiration of the term of the trust. The possibility that the grantor may die prior to the expiration of the specified term is not taken into account, nor is the value of any reversion retained by the grantor or the grantor's estate.

(59) Section 2702.—Special Valuation Rules in Case of Transfers of Interests in Trusts.—Whether a trust with one term holder satisfies the requirements of § 2702(a)(3)(A) and § 25.2702-5(c) to be a qualified personal residence trust.

(60) Section 2702.—Special Valuation Rules in Case of Transfers of Interests in Trusts.—Whether the sale of property (including insurance policies) to a trust by a trust beneficiary is subject to § 2702 if (i) the beneficiary has a power to withdraw the trust property (or had such power prior to a release or modification, but retains other powers which would cause that person to be the owner if the person were the grantor), other than a power which would constitute a general power of appointment within the meaning of § 2041, (ii) the trust purchases the property with a note, and (iii) the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

Finally, rulings related to private trust companies, decanting, or the basis adjustment, if any, of assets owned by a grantor trust, will not be issued until the IRS resolves the issue through publication of a revenue ruling, revenue procedure, or regulations. In addition, ING trusts have been moved to the “to be resolved” list from the “no ruling” list; INGs are described like this:

(9) Section 671.—Trust Income, Deductions, and Credits Attributable to Grantors and Others as Substantial Owners.—Whether the grantor will be considered the owner of any portion of a transfer in trust under §§ 673 to 677 that is purported to be an incomplete gift under § 2511, specifically including, but not limited to, a transfer to a trust providing for distributions at the direction of a committee to the donor and the committee members either by unanimous consent of the committee members or a majority of the committee members with the consent of the donor.

\* \* \*

(17) Section 2511.—Transfers in General.—Whether a transfer in trust that is purported not to be considered owned by the grantor under § 671 is an incomplete gift, specifically including, but not limited to, a transfer to a trust providing for distributions at the direction of a committee to the donor and the committee members either by unanimous consent of the committee members or a majority of the committee members with the consent of the donor.

## **Alleged Failure to Advise About Basis**

. A complaint styled Raia v. Lowenstein Sandler has been filed in the Superior Court of New Jersey Law Division: Civil Part, Bergen County (BER-L-000921-19). The essence of the action is the supposed failure of counsel to advise clients that assets given to dynasty trusts retain carryover basis and potential particular problems that could result from depreciation recapture upon the trusts ceasing to be grantor trusts when the grantor died. Regardless of the merits – if any – of the action, it is a reminder for estate planners.

## **Where Estate Tax Paid In Full, Late Return Not Cause For Penalty**

. Skeba v. United States, 2020 WL 70962 (D. NJ. 2020) involved a situation where estate tax was overpaid but the actual estate tax return was not filed until June 30, 2015, past the extension date of September 10, 2014. The IRS asserted a penalty because the tax was paid eight days past the original due date but an extension of time to pay, until September 10, 2014, had also been granted. The opinion states:

In the Court's view, the resolution of this matter hinges on an interpretation of a section of the IRS Code (26 C.F.R.§ 6651) called “Failure to file tax return or to pay tax.” This provision has several sections, and each shall be addressed.

Generally, § 6651 addresses the assessment of penalties for late filing of a return, and late payment of taxes due. More specifically, the penalty under § 6651(a)(1) addresses the failure to file a timely return:

In case of failure (1) to file any return on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount required to be shown as tax on such return 5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate ....

26 U.S.C. § 6651(a)(1).

On the other hand, the penalty for failure to timely pay the tax is set forth in § 6651(a)(2). This section reads:

In case of failure ... (2) to pay the amount shown as tax on any return specified in paragraph (1) on or before the date prescribed for payment of such tax (determined with regard to any extension of time for payment), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount shown as tax on such return 0.5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 0.5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate ...

§ 6651(a)(2).

The calculation of the penalty imposed for failure to timely file a return (subsection (a)(1)) and failure to timely pay the tax (subsection (a)(2)) is clarified in § 6651(b). It declares:

(b) Penalty imposed on net amount due. For purposes of--

(1) subsection (a)(1), the amount of tax required to be shown on the return shall be reduced by the amount of any part of the tax which is paid on or before the date prescribed for payment of the tax and by the amount of any credit against the tax which may be claimed on the return,

(2) subsection (a)(2), the amount of tax shown on the return shall, for purposes of computing the addition for any month, be reduced by the amount of any part of the tax which is paid on or before the beginning of such month and by the amount of any credit against the tax which may be claimed on the return[.]

§ 6651(b).

The parties disagree on how to construe these provisions. Plaintiff proffers two arguments in support of its position. First, Plaintiff argues that § 6651(a)(1) should be read together (in pari materia) with § 6651(b)(1). In reading these subsections together, Plaintiff concludes that the late filing penalty is calculated by using the formula set forth in subsection (a)(1), incorporating the “net amount due” on the “the date prescribed for payment” as set forth in subsection (b)(1). Since the estate tax was overpaid on March 18, 2014 and the extension ran until September 10, 2014, there was no net amount due on the September deadline; and hence, no penalty may be imposed.

Secondly, and in the alternative, Plaintiff argues that the phrase “such failure is due to reasonable cause not due to willful neglect” in subsection (a)(1) protects the taxpayer from a penalty if the return was filed late due to a reasonable cause.

The Government disagrees with the taxpayer's arguments. The Government proffers that the requirements of § 6651(a)(1) and (b) must be construed with another statute (26 U.S.C. § 6151) entitled “Time and place for paying taxes shown on returns.” § 6151 states: “[T]he date filed for payment of such tax shall be deemed a reference to the last day fixed for such payment (determined without regard to any extension of time for paying the tax).” More specifically, § 6151 reads in pertinent part:

(a) General rule. Except as otherwise provided in this subchapter [26 USCS § 6151 et seq.] when a return of tax is required under this title or regulations, the person required to make such return shall, without assessment or notice and demand from the Secretary, pay such tax to the internal revenue officer with whom the return is filed, and shall pay such tax at the time and place fixed for filing the return (determined without regard to any extension of time for filing the return).

\* \* \*

(c) Date fixed for payment of tax. In any case in which a tax is required to be paid on or before a certain date, or within a certain period, any reference in this title to the date fixed for payment of such tax shall be deemed a reference to the last day fixed for such payment (determined without regard to any extension of time for paying the tax).

Id. Based on § 6151, the Government cleverly reasons that the last day for payment was nine months after the death of Agnes **Skeba**—March 10, 2014; because no return was filed by that date a penalty may be assessed. Applying the rationale to the facts, the Government contends only $750,000 was paid on or before March 10, 2014, when $2,528,838 was due on that date. Referring back to § 6651(a)(1), a 25% penalty on the difference may therefore be assessed because it was not paid by March 10, 2014. As such, the full payment of the estate tax on March 18, 2014 is of no avail because the “last date fixed” was March 10, 2014. Accordingly, the Government argues that the imposition of a penalty in the amount of $450,959.00 is appropriate.

The IRS's arguments miss the mark. First, both §§ 6651(a)(1) and (a)(2) designate the specific day on which penalties will be assessed for both late filing and payment of the estate tax return. Both paragraphs specify that the “date prescribed” is to “be determined with regard to any extension of time for filing.” The language of the statute in dispute is the one which is given precedence over a more generic statute like § 6151. See La Vallee Northside Civic Asso. v. V.I. Coastal Zone Mgmt. Com., 866 F.2d 616, 621 (3d Cir. 1989); see also Meyers v. Heffernan, No. 12-2434 (MLC), 2014 WL 3343803, at \*8 (D.N.J. July 8, 2014).

The Government puts forth a valid point that there is an administrative need to complete and close tax matters. Here, the Estate had nine months to file the return, the extension added six months, and Defendant unilaterally added another nine months to file the return. Although there was the timely payment of the estate taxes, the matter, in the Government's view, lingered and the administrative objective to timely close the file was not met. See generally Boyle, 469 U.S. at 251, 105 S.Ct. 687. There may be a need for some other penalty for failure to timely file a return, but Congress must enact same.

The opinion noted that the lawyer and CPA for the estate had been repeatedly assured that there would be no penalty, and then that the assessment was a mistake. The case shows the peril of relying on such assurances.

Rev. Rul. 81-237 appears to require always a minimum penalty of $100. There was no mention of that ruling in the opinion. The United States has appealed to the Third Circuit.

## **Trustee of Revocable Trust Discharged From Personal Liability for Estate Tax**

. The facts of United States v. Paulson, 2020 WL 1821022 (S.D. Cal. 2020), were simple:

6. On July 19, 2000, Mr. Allen E. Paulson died. (Id.)

7. Mr. Allen E. Paulson's Will was filed with the Probate Court. (Id.) Michael Paulson and Edward White were appointed and served as Co-Executors of the Estate until Edward White's resignation effective October 8, 2001. (Id.) Thereafter, Michael Paulson served as a court appointed Executor until January 15, 2013 and ceased performing those duties as part of the 2013 Settlement Agreement with the Co-Trustees. (Id.) The Court determined that because there was no executor appointed by the probate court after Michael Paulson's attempted resignation in 2013, Michael Paulson is still the statutory executor, but not personally liable for any estate tax in that capacity. (Id. at 3–4.)

8. At the time of Mr. Allen E. Paulson's death, the Living Trust held all of Mr. Allen E. Paulson's assets except for 100% of the shares in the Gold River Hotel & Casino Corporation (hereafter “Gold River shares”), which were valued at $0.[1](https://1.next.westlaw.com/Document/I98fc87f07d6f11eab9c2847c6f7d4aa6/View/FullText.html?listSource=RelatedInfo&docFamilyGuid=I99e476f07d6f11eaa822dee5f819bfa0&originationContext=judicialHistory&transitionType=HistoryItem&contextData=%28sc.Search%29#co_footnote_B00012050754623) (Id. at 4.) The Living Trust's assets included real estate, stocks, bonds, cash, receivables and miscellaneous assets valued on the date of Mr. Allen E. Paulson's death at $193,434,344. (Id.) According to Form 706, the deductions[2](https://1.next.westlaw.com/Document/I98fc87f07d6f11eab9c2847c6f7d4aa6/View/FullText.html?listSource=RelatedInfo&docFamilyGuid=I99e476f07d6f11eaa822dee5f819bfa0&originationContext=judicialHistory&transitionType=HistoryItem&contextData=%28sc.Search%29#co_footnote_B00022050754623) totaled $178,495,454. (Id.)

9. Following Mr. Allen E. Paulson's death, Michael Paulson and Edward White became co-trustees of the Living Trust until White's resignation effective October 8, 2001. (Id.)

10. On October 11, 2001, Nicholas V. Diaco, M.D. consented to act as co-trustee of the Living Trust with Michael Paulson. (Id.) Michael Paulson only served as trustee of the Living Trust until March 24, 2009, when he was removed. (Id.)

11. After an extension of time to file the return, on October 23, 2001, the IRS received the Estate's Form 706 Estate Tax Return. (Id. at 5.) The return was signed by Michael Paulson as Co-Executor. (Id.) The Estate paid $706,296 concurrently with its filing of the Estate Tax Return. (Id.) The Estate elected to defer the payment of the balance of its estate taxes under Section 6166 of the Internal Revenue Code over the next 15 years. (Id.) Although the original amount of estate tax shown due by the Estate Tax Return has been paid, the additional assessment of estate tax made by the IRS in 2006 remains unpaid. (Id.)

12. At the same time he filed the Estate Tax Return with the IRS, Michael Paulson filed a cover letter with the Return and also filed a letter dated October 19, 2001 requesting a discharge under 26 U.S.C. § 2204. (Id.)

[emphasis added]

The issue was whether in the letter Paulson asked for discharge only as executor or as trustee too. The court found the request for discharge covered both:

As Michael Paulson points out, in contrast to Plaintiff's arguments that none of the procedures were followed, the letter sent to the IRS tells a different story. First, the title of the letter is “Request for discharge of fiduciaries from personal liability.” (Doc. No. 189-1 at 8.) The plural form of fiduciary may indicate that Michael Paulson sought to be discharged as a trustee and executor. Second, the letter enclosed (1) a copy of Federal Form 4768; (2) co-executor's Section 6166 election for deferral of federal estate tax; and (3) co-executor's request for discharge from personal liability pursuant to I.R.C. Section 2204. (Doc. No. 172 at 21.) As to the request for discharge, the letter is not specific as to whether Michael Paulson was requesting discharge under parts (a) or (b) or both of Section 2204. (Id.) Further, requesting the longer time frame of nine months was likely appropriate as it encompassed both the time frame to be discharged as a fiduciary and as an executor.

226 U.S.C. § 2204 does not specify how Michael Paulson was to sign the letter. Plaintiff produces no case law to support its position that the way in which Michael Paulson signed the letter only exhibits that he signed it only as an executor. Michael Paulson argues that he signed using the term “Co-Executor” as a way to identify Michael Paulson's title in a manner consistent with his title appearing on the federal estate tax return. (Doc. No. 189-1 at 11.) Currently, there is no authority that requires specific format, form or wording to make an application for discharge. See United States v. Johnson, 224 F. Supp. 3d 1220, 1237 (D. Utah 2016) (“[Johnson II](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=2040430627&pubNum=0007903&originatingDoc=I98fc87f07d6f11eab9c2847c6f7d4aa6&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.Keycite))”), reversed on other grounds United States v. Johnson, 920 F.3d 639 (10th Cir. 2019). However, Plaintiff argues that Michael Paulson signed various documents in different capacities and sometimes would sign the same document multiple times in his differing capacities. (Doc. No. 191-1 at 19–21.) There is no such requirement, however, how to sign the letter nor is there a requirement that Michael Paulson was supposed to provide two letters to the IRS.

The court appeared offended that the IRS took 12 years to raise the issue:

Further, the IRS never contacted Michael Paulson regarding any confusion over the letter. In fact, the IRS never responded to the letter. The IRS is “to notify the fiduciary (1) of the amount of such tax for which it has been determined the fiduciary is liable, or (2) that it has been determined that the fiduciary is not liable for any such tax.” 26 U.S.C. § 2204. If there was any confusion, Plaintiff argues that the IRS should have alerted the fiduciary that he remained liable for the full amount of “any estate tax for which the fiduciary may be personally liable.” The Court agrees. Plaintiff should not have waited twelve years to raise this issue in litigation.

## **Reminder That Private Postage Meter Yields To Official Post Office Time Stamp**

. In Thomas v. Commissioner, T.C. Memo. 2020-33, the taxpayer’s Tax Court petition was required to be filed by March 5, 2018 (90 days after the issuance of the Notice of Deficiency). The opinion states:

Petitioners assert that petitioner husband took the petition to the Fernley [Nevada] USPS office on March 5, 2018, and placed it in the mailbox before 5 p.m., the last mail pickup time at that office. The Fernley USPS office, however, postmarked the envelope on March 6, 2018. Respondent speculates that the USPS office may have already been closed by the time petitioner husband placed the petition in the mailbox, which may be why the envelope was postmarked the day after the alleged mailing date. Respondent also notes that had petitioner husband taken the petition to the Reno USPS office the envelope would have been postmarked on that same day because that office postmarks mail pieces until 11:59 p.m.

We follow the guidelines the regulations provide us. In this instance the regulations instruct us that where the envelope containing the petition bears a legible USPS postmark, the postmark must bear a date on or before the last date prescribed for filing for it to be considered timely filed. See sec. 301.7502 -1(c)(1)(iii)(A), Proced. & Admin. Regs. Accordingly, even if we were to credit petitioners’ assertions that they timely deposited the petition in the mail, the petition is still considered not timely filed because the USPS postmark on the envelope does not bear a date on or before March 5, 2018. See id. Further, because petitioners mailed the petition using postage printed through a private postage meter with no request that a certified mail receipt be postmarked by a USPS employee, they are not entitled to any relief under section 301.7502-1(c)(2), Proced. & Admin. Regs. Accordingly, the Court lacks jurisdiction under sections 6213(a) and 7502 to redetermine the deficiency, and we are obliged to grant respondent’s motion to dismiss.

The administrative regulation is clear:

Section 301.7502-1(c)(1)(iii)(B)(3), Proced. & Admin. Regs., provides for situations in which a mailpiece has both a USPS postmark and a non-USPS mark. That section provides as follows:

If the envelope has a postmark made by the U.S. Postal Service in addition to a postmark not so made, the postmark that was not made by the U.S. Postal Service is disregarded, and whether the envelope was mailed in accordance with this paragraph (c)(1)(iii)(B) will be determined solely by applying the rule of paragraph (c)(1)(iii)(A) of this section.

## **Executor Personally Liable For Estate Tax**

. In United States v. Kohls, 2020 WL 33410 (S.D. Ohio 2020) the executor didn’t pay the estate tax owed, transferred the estate assets, and closed the estate. At issue was the statute of limitations on the IRS. The opinion states:

Corwin J. Kohls died testate on September 10, 2001. On September 12, 2001, Douglas M. Kohls, his son, opened an estate in the Common Pleas Court of Montgomery County, Ohio, Probate Division ("Probate Court") and was named the executor.

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The IRS audit of the 706 Return was completed and, on or about May 27, 2005, the executor signed a Form 890, Waiver of Restriction on Assessment and Collection of Deficiency and Acceptance of Overassessment - Estate Gift and Generation Skipping Transfer Tax ("Assessment Waiver"). In the Assessment  Waiver, the executor consented to the immediate assessment and the collection of a $199,077 estate tax deficiency. On that same date, the executor also signed a Form 4768, Application for Extension of Time to File a Return and/or Pay U.S. Estate (and Generation Skipping Transfer) -Taxes" ("Application for Extension"). Pursuant to 26 U.S.C. § 6161(b)(2). The IRS granted the Estate a one-year extension for payment so that the federal estate tax of $199,077, plus interest, was now due on or before May 27, 2006.

Pursuant to 26 U.S.C. § 6203, on July 4, 2005, the IRS made an assessment against the Estate of the $199,077 estate tax deficiency. Doc. #7-2, PAGEID##49-50; Doc. #7-1, PAGEID#35.

On August 12, 2005, and October 12, 2005, the Estate, through the executor, transferred two properties for no consideration. Specifically, on August 12, 2005, the Estate transferred property located at 8305-8311 Woodgrove Drive in Centerville, Ohio, ("Woodgrove Drive Property") to Defendant's sister, Cynthia L. Rogers. On October 12, 2005, property in the Estate located at 4627-4629 Far Hills Avenue, Kettering, Ohio, ("Far Hills Avenue Property") was transferred to Defendant individually. Using the date of death values and subtracting the mortgages, the net equity of the Woodgrove Drive Property was $53,439 and the net equity of the Far Hills Avenue Property was $571,001. Doc. #7-1, PAGE ID #37.

On May 27, 2006, the executor signed a second Application for Extension seeking another one-year extension to pay the Estate's taxes. This extension was also granted and payment of the tax deficiency was extended until May 27, 2007.

Although the federal tax deficiency was unpaid, the Estate was closed in February 2007. On May 27, 2007, the third and final Application for Extension was signed by the executor and granted by the IRS. As a result, payment of the Estate's tax and interest was due on May 27, 2008.

As of May 8, 2018, the amount of the Estate's federal estate tax liabilities, "taking into account the assessments of taxes, penalties and interest, and all payments, credits, abatements, and accruals" totaled $322,875.43. Doc. #7-5, PAGEID#166.

The IRS had 13 years to sue, but starting when?

In addition to the ten years to file suit, Defendant concedes that because of the three one-year extensions that were granted by the IRS in the Applications for Extension, Form 4768, 26 U.S.C. § 6161(b)(2) extends the ten-year statute of limitations for an additional three years. According to Defendant, because he  signed the Assessment Waiver, also known as the Form 890, on May 27, 2005, the thirteen-year time period begins to run from this date. As such, the statute of limitations ran on May 27, 2018, and Defendant's Motion should be sustained. Doc. #8, PAGEID183.

Alternatively, Defendant argues that the latest period of time to start the running of the ten-year statute of limitations under 26 U.S.C. § 6502 is the date when the IRS received the signed May 27, 2005, Assessment Waiver. Defendant asserts that the IRS's date of receipt of the Assessment Waiver was June 2, 2005. Based on this argument, Defendant asserts that under § 6502(d) and the three one-year extensions, the "alternate collection statute expiration date" is June 2, 2018, which is thirty days before the Complaint was filed. Doc. #8, PAGEID#183.

In response to Defendant's statute of limitations defense, although Plaintiff agrees that it had 13 years to file its Complaint, it disputes that the May 27, 2005, Assessment Waiver is the starting point. Specifically, the United States argues that the "assessment" referred to in 26 U.S.C. § 6502 is not the Assessment Waiver Defendant signed on May 27, 2005. According to Plaintiff, "[A]n assessment is made 'by recording the liability of the taxpayer in the office of the Secretary in accordance with rules and regulations prescribed by the Secretary.'" 26 U.S.C. § 6203. *Laing v*. *United States*, 423 U.S. 161, 170 n.13 (1976) ("The assessment is essentially a bookkeeping notation that is made when the Secretary or his delegate establishes an account against the taxpayer on the tax rolls."). As such, Plaintiff argues that its Complaint was timely filed.

The Court finds that Defendant's reliance on the Assessment Waiver, Form 890, as the "assessment" referred to in 26 U.S.C. § 6502 is misplaced. A "Form 890 is a waiver of restriction on assessment and collection of the deficiency. It is not an assessment." *Singleton v*. *C*.*I*.*R*., 71 T.C.M. (CCH) 3127, \*3, n. 3 (T.C. 1996).

An assessment is made by recording the liability of a taxpayer in the office of the Secretary in accordance with prescribed rules or regulations. Sec. 6203. The date of assessment is the date the summary record of assessment is signed by the assessment officer. Sec. 301.6203-1, Proced. & Admin.

*Id*.

## **Meaning of Tax Reimbursement Clause**

. At issue in Karimipour v. Karimipour (In re Davidson Magnifying Glass Non-Exempt Trust, 2021 WL 137262 (Mich. Ct. App. 2021), was whether the tax reimbursement clause in a trust required the trustee to pay out the amount of the “unified credits” used. The opinion states:

Under Article IV(4)(e) of the trust agreements, if Marla or Ethan “exercises a power of appointment and Transfer Taxes are imposed” as a result of the transfer of trust property, the trustees are required to pay those “Transfer Taxes as provided in the Paragraph entitled Payment of Taxes.” In relevant part, Article X of the trust agreements provides the following:

1. Payment of Taxes. Following any transfer of Trust Property which results in any Transfer Taxes to the beneficiary of any trust created under this trust instrument, the Trustee shall reimburse such beneficiary or distribute trust property to such beneficiary in accordance with the following:

a. If so directed by the beneficiary or the Personal Representative of the beneficiary's estate, the Trustee shall pay from the remaining property held in a trust for the beneficiary, directly to the appropriate governmental authority, to the beneficiary or to the Personal Representative of the beneficiary's estate, as the Trustee deems advisable, without seeking reimbursement or recovery from any Person, the amount by which the Transfer Taxes payable in any jurisdiction by reason of the transfer are increased.

\* \* \*

"Transfer Taxes" are defined in Article XVI of the trust agreements to "mean[] . . . any gift taxes, including taxes arising pursuant to , and any gift, transfer or other similar succession taxes imposed by any state resulting from a transfer subject to federal gift tax[.]" Although the definition of "Transfer Taxes" includes "any gift taxes," under Article X, paragraph (1)(a) of the trust agreements, the taxes must also be "payable."

Does gift taxes “payable” mean the total gift tax or the net, after the application of the donor’s unified credit? The court held that payable means the amounts actually paid:

The sums of money that were required to be paid—and that were actually paid—to the Internal Revenue Service ("IRS") by Marla and Ethan were their respective gift taxes, which were calculated after the application of the unified credits. Marla and Ethan did not actually pay a sum of money with respect to the unified credits because a unified credit is not a tax that must be paid to the IRS. See e.g., 26 USC 2505. Rather, as evidenced by the facts of this case, a unified credit is used to calculate the gift taxes that must be paid to the IRS, and the credits function to decrease the amount of money owed to the IRS. Accordingly, under the terms of the trust agreements, the amount of gift taxes payable means the amount of gift taxes calculated after the application of the unified credits. Consequently, because the use of the unified credits does not constitute payment of a gift tax, the trustees were not required to reimburse Marla and Ethan for the value of the unified credits.

Although unusual, the case is a good illustration generally of the importance of carefully drafted tax clauses. Who ought to benefit from unified credits/exemption/applicable exclusion is not obvious in every case.

## **User Fee For Closing Letter**

. On December 31, 2020 Treasury issued a proposed regulation allowing but requiring an estate to pay $67 to obtain an estate tax closing letter. REG-114615-16. In June, 2015 the IRS stopped issuing closing letters automatically, which had been the previous, long-time practice. Because closing letters were regularly issued, state revenue authorities, probate courts, and others were accustomed to receiving them as evidence that “ almost certainly” — in colloquial language — the IRS exam of the estate was finished and the taxes paid. With the change the IRS proposed a new system that allowed an estate to request a closing letter or for the taxpayer estate to receive a transcript of the audit. The procedure never worked very well from the practitioner point of view and got much worse in the spring of 2020 during the pandemic. Interestingly, the stated rationale for the change was the enormous increase in DSUE/portability returns; in 2016, 12,000 regular estate tax returns but 20,000 DSUE returns.

Payment of $67 to restore the former custom is an improvement (unless you are a taxpayer who thinks your taxes are already paying for a closing letter, described by the proposed regs as a “customer service convenience”). However, the IRS has not simply added the fee as an option on the Form 706 but rather has a different procedure in mind:

Guidance on the procedure for requesting an estate tax closing letter and paying the associated user fee is not provided in these proposed regulations. The Treasury Department and the IRS expect to implement a procedure that will improve convenience and reduce burden for authorized persons requesting estate tax closing letters by initiating a one-step, web-based procedure to accomplish the request of the estate tax closing letter as well as the payment of the user fee. As presently contemplated, a Federal payment website, such as http://www.pay.gov, will be used and multiple requests will not be necessary. The Treasury Department and the IRS believe implementing such a one-step procedure will reduce the current administrative burden on authorized persons in requesting estate tax closing letters and will limit the burden associated with the establishment of a user fee for providing such service.

The AICPA suggested payment with the 706 in a comment dated February 25, 2021, with a box to check on the 706 and until then the executor handwriting the request at the top of the return. One hopes such common sense practices are adopted.

## **CBO Publication, Understanding Federal Estate and Gift Taxes**

. The Congressional Budget Office has published Understanding Federal Estate and Gift Taxes (June 2021) which contains interesting data, including:

Who Pays Estate and Gift Taxes?

Relatively few people pay estate and gift taxes. Among the 2.7 million decedents in 2016, about 13,000 estates were required to file a return—and of those, 5,500 estates owed taxes. CBO projects that the number of taxable estates will drop to 2,800 among 2021 decedents because of the higher exemption allowed by the 2017 tax act. In terms of gift taxes, about 236,000 gift tax returns were filed in 2018, but only 2,000 of those owed the tax. People who do not pay estate taxes may still be affected by them; that group includes heirs and people who engage in estate planning (the process of managing and allocating assets while a person is still alive) to avoid or lessen the tax.

People Who Pay Estate and Gift Taxes

Widowed decedents and people age 80 or older accounted for the majority of taxable returns filed and estate taxes paid among decedents in 2016.[9](https://www.cbo.gov/publication/57272#footnote-021) Most estates that filed an estate tax return in that year belonged to widowed decedents who were 80 or older.

* About 64 percent of taxable returns were filed by the estates of widowed decedents, and those returns accounted for 54 percent of estate tax revenues.
* About 78 percent of taxable returns were filed by the estates of decedents age 80 or older, and those returns accounted for 80 percent of estate tax revenues.

In addition, most taxable returns were filed by relatively small estates, even though most estate tax revenues came from the largest estates.

* In 2016, estates with a gross value of $10 million or less accounted for 57 percent of taxable returns but only 11 percent of estate tax revenues.
* Estates with a gross value of $50 million or more filed 5 percent of taxable returns but accounted for 46 percent of estate tax revenues.

In 2018, 22 percent of taxable gifts were at least $1 million, and they accounted for 86 percent of gift tax revenues. Typically, filers must apply their estate tax exemption to the gift tax, which reduces their gift tax liability. The estate tax exemption available when those filers die, however, will be reduced by the amounts previously applied to the gift tax while they were alive.

Other Affected People

The estate tax affects people who do not pay it directly, such as heirs. Some people engage in estate planning to avoid paying the tax (or to reduce the amount that they owe), which may result in ownership arrangements for their assets that they would otherwise not choose. For example, people might transfer assets through a trust to their heirs earlier than they had intended so as to remove those assets from their estate.[10](https://www.cbo.gov/publication/57272#footnote-020) Although the decedent’s estate is responsible for paying estate taxes, the tax reduces the amount that heirs may receive.[11](https://www.cbo.gov/publication/57272#footnote-019)

Heirs tend to have relatively high income. Families that received an inheritance in 2019—about 3 percent of all families according to the 2019 Survey of Consumer Finances—typically had a higher median income than other families ($92,000 compared with $58,000).[12](https://www.cbo.gov/publication/57272#footnote-018) About half of the heirs were between the ages of 55 and 75, and most received inheritances from their parents. Those inheritances did not necessarily come from a taxable estate. The median inheritance was $50,000, and the average inheritance was $186,000 (because of a relatively small number of large inheritances).

Do Estate and Gift Taxes Affect Saving?

Because the estate tax is imposed on the transfer of assets, it in effect taxes people’s savings. The amount of estate tax that people pay varies—even among people with similar resources—depending on what they choose to do with their money. For instance, the tax on an estate left by someone who saves more will be higher than the tax on an estate left by someone who spends more. As a result, the estate tax could encourage people to save and invest less by making it more expensive for them to leave money to their heirs. Overall, however, the empirical evidence on the effect of the estate tax on saving is inconclusive.[13](https://www.cbo.gov/publication/57272#footnote-017)

The lack of consensus about the overall effect of the estate tax on saving stems from several factors. The smaller inheritances left to heirs because of the estate tax might induce people, or their heirs, to save more. Alternatively, estate taxes would have little effect on the saving behavior of people who do not intend to leave an inheritance. Another consideration is the way capital gains taxes apply to the value of inherited assets (see Box 1). Because of the step up in basis—upon inheritance, the cost basis of an asset is increased to its fair-market value—any appreciation in value while the decedent held the asset is not subject to capital gains taxes, which could motivate people to save more.

# MISCELLANEOUS

PART 4 – STATE DEVELOPMENTS

# STATE DEVELOPMENTS

## **Child Support vs. Special Needs**

. Alexander v. Harris, 2019 WL 2147281 (Fl. App. 2019) dealt with a fascinating policy issue. A father was the beneficiary of a special needs trust established when he was injured in a car accident. He owed about $92,000 in child support. The special needs trust received more monthly than the father’s expenses and thus had accumulated about $142,000. Could the $92,000 be paid from the trust. The court held yes stating:

The father argues that using the trust's funds to satisfy his support obligations would jeopardize his eligibility for public assistance under federal law; however, he cannot identify any legal basis for this conclusion. We can find no federal law or regulation expressly addressing the garnishment of a special needs trust to satisfy a support obligation. To the extent that 42 U.S.C. § 1396p discusses support payments and eligibility, subsection (c)(2)(B)(iii) states that "[a]n individual shall not be ineligible for medical assistance by reason of paragraph (1) to the extent that . . . the assets . . . were transferred to . . . the individual's child." Furthermore, federal law gives great deference to state courts in family law proceedings, and the Supreme Court has explained that "[s]tate family and family-property law must do 'major damage' to 'clear and substantial' federal interests before the Supremacy Clause will demand that state law be overridden." *Hisquierdo v. Hisquierdo*, 439 U.S. 572, 581 (1979) (quoting *United States v. Yazell*, 382 U.S. 341, 352 (1966)). In *Rose v. Rose*, 481 U.S. 619, 630 (1987), the Supreme Court recognized that payment of child support is in the parent's best interest, explaining that federal "benefits are not provided to support [the beneficiary] alone." There is no indication in the federal statutes that Congress has expressed any intention to preempt state statutes, like section 736.0503, that permit garnishment of spendthrift trusts to satisfy the child support obligations of the beneficiary. Id. at 628 ("Given the traditional authority of state courts over the issue of child support, their unparalleled familiarity with local economic factors affecting divorced parents and children, and their experience in applying state statutes . . . that do contain detailed support guidelines and established procedures for allocating resources following divorce, we conclude that Congress would surely have been more explicit had it intended the Administrator's apportionment power to displace a state court's power to enforce an order of child support.").

Resolution of this case requires consideration of the equities between these particular parties and resolution of competing public policies related to the enforceability of spendthrift provisions and the payment of support.

On the one hand, there is the long held policy of this state that recognizes the validity of spendthrift trusts. On the other hand, there is the even longer held policy of this state that requires a former spouse or a parent to pay alimony or child support in accordance with court orders.

*Bacardi*, 463 So. 2d at 221. Where the two conflict, this court has held that Florida's public policy favoring enforcement of support orders takes precedence. *Berlinger*, 133 - 6 - So. 3d at 966 ("Florida has a public policy favoring spendthrift provisions in trusts and protecting a beneficiary's trust income; however it gives way to Florida's strong public policy favoring enforcement of alimony and support orders."). Thus, although the trial court correctly recognized the compelling equitable interests of the parties in this case, we must nevertheless reverse. The special needs trust does not protect the father from his legal obligation to support his child. A continuing writ of garnishment is appropriate in this case, and the court may limit the award to such relief as is appropriate under the circumstances. *See* § 736.0503(3).

## **South Dakota Refuses To Enforce California Child Support Order**

. In Matter Cleopatra Cameron Gift Trust, Dated May 26, 1998, 931 N.W.2d 244 (SD. 2019), the South Dakota Supreme Court held that a California order directing a trustee to pay child support for a beneficiary’s children was not entitled to full faith and credit in South Dakota because it was a method of enforcement only. The opinion states:

The Full Faith and Credit Clause of the United States Constitution provides that, “Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State.” [U.S. Const. art. IV, § 1](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000583&cite=USCOARTIVS1&originatingDoc=I48ab272098f011e9b508f0c9c0d45880&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)). The command to afford the judgments of foreign states full faith and credit is further codified at [28 U.S.C. § 1738 (2013)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000546&cite=28USCAS1738&originatingDoc=I48ab272098f011e9b508f0c9c0d45880&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)), which provides that authenticated records and judicial proceedings “shall have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State[.]”

The United States Supreme Court has recognized that providing full faith and credit to the judgments of foreign states serves the salutary purpose of limiting the opportunity to relitigate issues that have been resolved previously through the judicial process. [*Riley v. New York Trust Co.*, 315 U.S. 343, 348-49, 62 S. Ct. 608, 612, 86 L. Ed. 885 (1942)](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1942120618&pubNum=0000708&originatingDoc=I48ab272098f011e9b508f0c9c0d45880&refType=RP&fi=co_pp_sp_708_612&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_708_612). As a result, the Full Faith and Credit Clause “alter[s] the status of the several states as independent foreign sovereignties, each free to ignore obligations created under the laws or by the judicial proceedings of the others, and ... make[s] them integral parts of a single nation.” [*V.L. v. E.L.*, ––– U.S. ––––, 136 S. Ct. 1017, 1020, 194 L. Ed. 2d 92 (2016)](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=2038422531&pubNum=0000708&originatingDoc=I48ab272098f011e9b508f0c9c0d45880&refType=RP&fi=co_pp_sp_708_1020&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_708_1020) (per curiam) (quoting [*Milwaukee County v. M.E. White Co.*, 296 U.S. 268, 277, 56 S. Ct. 229, 234, 80 L. Ed. 220 (1935)](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1935124059&pubNum=0000708&originatingDoc=I48ab272098f011e9b508f0c9c0d45880&refType=RP&fi=co_pp_sp_708_234&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_708_234)); *see also* [*Wooster v. Wooster*, 399 N.W.2d 330, 334 (S.D. 1987)](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1987002938&pubNum=0000595&originatingDoc=I48ab272098f011e9b508f0c9c0d45880&refType=RP&fi=co_pp_sp_595_334&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_595_334) (recognizing that valid foreign judgments are given effect in the interests of comity).

Generally, if the judgment was “rendered by a court with adjudicatory authority over the subject matter and persons governed by the judgment, [it] qualifies for recognition throughout the land.” [*Id.*](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1987002938&pubNum=0000595&originatingDoc=I48ab272098f011e9b508f0c9c0d45880&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) Furthermore, “[a] State may not disregard the judgment of a sister State because it disagrees with the reasoning underlying the judgment or deems it to be wrong on the merits.” [*Id.*](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1987002938&pubNum=0000595&originatingDoc=I48ab272098f011e9b508f0c9c0d45880&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)); *see also* [*Milliken v. Meyer*, 311 U.S. 457, 462, 61 S. Ct. 339, 342, 85 L. Ed. 278 (1940)](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1941121795&pubNum=0000708&originatingDoc=I48ab272098f011e9b508f0c9c0d45880&refType=RP&fi=co_pp_sp_708_342&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_708_342) (“[T]he full faith and credit clause of the Constitution precludes any inquiry into the merits of the cause of action, the logic or consistency of the decision, or the validity of the legal principles on which the judgment is based.”).

There are, however, certain limitations upon the requirements of the Full Faith and Credit Clause. Providing full faith and credit to a foreign state’s judgment “does not mean that States must adopt the practices of other States regarding the time, manner, and mechanisms for enforcing judgments. Enforcement measures do not travel with the sister state judgment as preclusive effects do; such measures remain subject to the evenhanded control of forum law.” [*Baker by Thomas v. Gen. Motors Corp.*, 522 U.S. 222, 235, 118 S. Ct. 657, 665, 139 L. Ed. 2d 580 (1998)](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1998030801&pubNum=0000708&originatingDoc=I48ab272098f011e9b508f0c9c0d45880&refType=RP&fi=co_pp_sp_708_665&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_708_665); *see also* [Restatement (Second) of Conflict of Laws § 99 (1971)](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=0289353496&pubNum=0101576&originatingDoc=I48ab272098f011e9b508f0c9c0d45880&refType=TS&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) (“The local law of the forum determines the methods by which a judgment of another state is enforced.”). “ ‘Evenhanded’ means only that the state executes a sister state judgment in the same way that it would execute judgments in the forum court.” [*Adar v. Smith*, 639 F.3d 146, 159 (5th Cir. 2011)](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=2024984973&pubNum=0000506&originatingDoc=I48ab272098f011e9b508f0c9c0d45880&refType=RP&fi=co_pp_sp_506_159&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_506_159).

Justice Scalia, in his concurring opinion in [*Baker*](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1998030801&pubNum=0000708&originatingDoc=I48ab272098f011e9b508f0c9c0d45880&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)), noted that the power of the Full Faith and Credit Clause is to make the judgment of “one State[ ] conclusive evidence in the courts of another State[.]” [522 U.S. at 242, 118 S. Ct. at 668](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1998030801&pubNum=0000708&originatingDoc=I48ab272098f011e9b508f0c9c0d45880&refType=RP&fi=co_pp_sp_708_668&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_708_668) (Scalia, J. concurring) (quoting [*Wisconsin v. Pelican Ins. Co.*, 127 U.S. 265, 291-92, 8 S. Ct. 1370, 1375, 32 L. Ed. 239 (1888)](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1888180203&pubNum=0000708&originatingDoc=I48ab272098f011e9b508f0c9c0d45880&refType=RP&fi=co_pp_sp_708_1375&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_708_1375)). Yet despite the preclusive power of one state’s judgment, it “can only be executed in [the forum state] as its laws may permit.” [*Id.*](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1998030801&pubNum=0000780&originatingDoc=I48ab272098f011e9b508f0c9c0d45880&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) (quoting [*Lynde v. Lynde*, 181 U.S. 183, 187, 21 S. Ct. 555, 556, 45 L. Ed. 810 (1901)](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1901104017&pubNum=0000708&originatingDoc=I48ab272098f011e9b508f0c9c0d45880&refType=RP&fi=co_pp_sp_708_556&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_708_556)); *see also* [*Adar*, 639 F.3d at 161](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=2024984973&pubNum=0000506&originatingDoc=I48ab272098f011e9b508f0c9c0d45880&refType=RP&fi=co_pp_sp_506_161&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_506_161) (holding there was no violation of the Full Faith and Credit Clause where a Louisiana registrar recognized the validity of a New York adoption decree, but only allowed one unmarried parent’s name on the Louisiana birth certificate because under Louisiana law, only married couples could jointly adopt).

Here, an examination of the statute upon which the family court relied to order direct Trust payments to Christopher reveals it to be a conspicuous method of enforcing a support obligation where an obligor is the beneficiary of a trust protected by a spendthrift provision:

(c) Whether or not the beneficiary has the right under the trust to compel the trustee to pay income or principal or both to or for the benefit of the beneficiary, the court may, to the extent that the court determines it is equitable and reasonable under the circumstances of the particular case, *order the trustee to satisfy all or part of the support judgment* out of all or part of future payments that the trustee, pursuant to the exercise of the trustee’s discretion, determines to make to or for the benefit of the beneficiary.

(d) This section applies to a support judgment notwithstanding any provision in the trust instrument.

[Cal. Prob. Code § 15305](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000218&cite=CAPRS15305&originatingDoc=I48ab272098f011e9b508f0c9c0d45880&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) (emphasis added.)

It is equally clear that the [*Ventura County*](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=2004271675&pubNum=0007047&originatingDoc=I48ab272098f011e9b508f0c9c0d45880&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) court also perceived [Cal. Prob. Code § 15305](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000218&cite=CAPRS15305&originatingDoc=I48ab272098f011e9b508f0c9c0d45880&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) to be an enforcement provision. The [*Ventura County*](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=2004271675&pubNum=0007047&originatingDoc=I48ab272098f011e9b508f0c9c0d45880&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) court broadened the enforcement authority of California trial courts to order direct trust payments, notwithstanding a spendthrift provision, upon a finding the trustee acted in bad faith by not authorizing a distribution. The court described [Cal. Prob. Code § 15305](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000218&cite=CAPRS15305&originatingDoc=I48ab272098f011e9b508f0c9c0d45880&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) as a means of enforcing the support order, observing, “A spendthrift provision ‘is not effective to exempt the trust from *enforcement of a judgment for support of a minor child* ....’ ” [*Ventura Cty.*, 11 Cal. Rptr. 3d at 495](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=2004271675&pubNum=0007047&originatingDoc=I48ab272098f011e9b508f0c9c0d45880&refType=RP&fi=co_pp_sp_7047_495&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_7047_495) (emphasis added) (quoting [Cal. Prob. Code § 15305](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000218&cite=CAPRS15305&originatingDoc=I48ab272098f011e9b508f0c9c0d45880&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)), cmt.).

Viewed in this context, the family court’s order compelling the direct payment of child support from the Trust was an unmistakable means of enforcing Cleopatra’s obligation. Christopher’s counsel acknowledged at oral argument that the direct payment order was, in truth, an enforcement method. In our view, the trustee was not the child support obligor and was only nominally joined in the divorce action to enforce Cleopatra’s obligation. Because the means of enforcing judgments does not implicate full faith and credit considerations, the circuit court here was not required to submit to the California order compelling direct payments from the Trust if this method of self-executing enforcement is not authorized by South Dakota law. Based upon a review of our relevant statutes, it is not authorized and is, in fact, expressly prohibited.

Our Legislature has placed formidable barriers between creditor claims and trust funds protected by a spendthrift provision. *See* [SDCL 55-1-41](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000359&cite=SDSTS55-1-41&originatingDoc=I48ab272098f011e9b508f0c9c0d45880&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) (“If the trust contains a spendthrift provision, no creditor may reach present or future mandatory distributions from the trust at the trust level.”); [SDCL 55-1-35](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000359&cite=SDSTS55-1-35&originatingDoc=I48ab272098f011e9b508f0c9c0d45880&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) (“No trustee is liable to any creditor for paying the expenses of a spendthrift trust.”). More to the point, the Legislature has emphatically rejected even the specter of an argument that would allow a child support creditor to reach trust funds protected by a spendthrift provision. Indeed, this precise legal theory is identified in § 59 of the Restatement (Third) Trusts (2003) which states that “[t]he interest of a beneficiary in a valid spendthrift trust can be reached in satisfaction of an enforceable claim against the beneficiary for ... support of a child ....” However, the Legislature anticipated such an argument in South Dakota courts and definitively foreclosed it with its 2007 enactment of [SDCL 55-1-25](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000359&cite=SDSTS55-1-25&originatingDoc=I48ab272098f011e9b508f0c9c0d45880&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) which provides in part:

In the area of creditor rights, the Restatement of Trusts (Third) and the Uniform Trust Code create many new positions of law as well as adopts many minority positions of law. The provisions of §§ 55-1-24 to 55-1-43, inclusive, affirmatively reject many of these positions. *Therefore, the Legislature does not intend the courts to consult the* [*Restatement (Third) of the Law of Trusts ... § 59*](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=0291389153&pubNum=0121207&originatingDoc=I48ab272098f011e9b508f0c9c0d45880&refType=TS&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) *... with respect to subject matters addressed by the provisions of §§ 55-1-24 to 55-1-43, inclusive.*

(Emphasis added); *see also* [*Richardson v. Richardson*, 2017 S.D. 92, ¶ 16, 906 N.W.2d 369, 374](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=2043519845&pubNum=0000595&originatingDoc=I48ab272098f011e9b508f0c9c0d45880&refType=RP&fi=co_pp_sp_595_374&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_595_374) (stating that courts “must be mindful of the Legislature’s public policy determinations ....”).

The trust had been subject to various courts in California during the divorce of a beneficiary, Cleopatra. Cleopatra was at that time a co-trustee with a corporate fiduciary. Ultimately Cleopatra changed situs to South Dakota, with positive results (assuming she didn’t want to pay continuing child support).

## **Failure to Discuss Basis Planning**

. Stevenson v. Stanyer, 2019 WL 2895378 (Wa. Ct. App., Div. 3)(unreported).

Income tax basis planning is increasingly a part of estate planning and became the subject of a malpractice claim in Spokane, Washington. Many years ago, Dr. and Mrs. Richard Stevenson transferred a lake house in Idaho into a trust to avoid estate tax on the property. Dr. Stevenson died in 1989 and the trust worked as intended with the property remaining in the trust for Mrs. Stevenson’s benefit until her death in 2016. Mrs. Stevenson’s children decided to sell the lake house and learned they would owe capital gains taxes whereupon Mrs. Stevenson’s son, as executor, sued the lawyer who had updated Mrs. Stevenson’s will, power of attorney, and health care directive some six months before she died. The opinion states that the “essence of the complaint” was that the lawyer should have advised Mrs. Stevenson to have entered into an agreement with the trust beneficiaries to dissolve the trust, take the lake house into her personal name, and receive increased basis, none of which would cause any estate tax to be owed because of the increased estate exemption. The damages were $159,000 in capital gains taxes.

The lawyer defended on the grounds that he was not asked to do any tax work on behalf of the beneficiaries. The decedent’s son remembered his mother’s “clear intention” that her death not result in a taxable event to her estate or her beneficiaries but the court found that there was no evidence such intent was ever expressed to the lawyer. The opinion notes that “[t]here is simply no indication that her desire to avoid tax consequences for the children was ever communicated to Mr. Stanyer. Similarly, the e-mail communications between Stanyer and Stevenson, offered into the record by both parties, do not mention the issue of tax advice.” The court concluded that it “is difficult to see how any general duty to provide tax advice for her estate would encompass tax advice for the beneficiaries of the trust she controlled.”

Many lawyers make more expansive claims for the sort of advice we are providing to a client, and in many instances actually represent both the parents and children or at least some of the children. Arguably the successful defense made by the lawyer here would be more difficult in such instances.

## **Trust Protector As Fiduciary With A Duty To Whom?**

Ron v. Ron, 2020 WL 1426392 (S.D. Tx. 2020), deals with the alleged dissipation of assets in connection with a divorce. Directly pertinent to estate planners is a question addressed by the court regarding a trust protector in a children’s trust, the recipient of some of the alleged dissipation. The relevant language of the children’s trust was:

The Trust states: “The purpose of a Trust Protector is to direct my Trustee in certain matters concerning the trust, and to assist, if needed, in achieving my objectives as expressed by the other provisions of my estate plan hereunder.” Id. at 17. The Trust explicitly empowers the Trust Protector to carry out several duties. Relevant here, the Trust provides:

The Trust Protector may add as a beneficiary of any trust established hereunder (i) any descendant of my husband’s parents; (ii) any spouse or surviving spouse of any such descendant (other than me); and (iii) any charity, subject to any limitations the Trust Protector determine appropriate. The Trust Protector may also remove any beneficiary who was added under this subsection.

The wife was upset because the trust protector added husband as a beneficiary of a trust she had created (to which husband had transferred assets). Wife, Suzanne, claimed the trust protector, Stein, had a fiduciary duty to her. The court held that neither the trust nor Texas law created such a fiduciary relationship:

In my view, nothing in Section 4.01 of the Trust creates a fiduciary relationship between Stein and Suzanne. If anything, the provision strongly suggests that the fiduciary relationship is between Stein and the Trustee—who Stein is to “direct” and “assist”—or perhaps, between Stein and the Trust—which contains Suzanne’s memorialized objectives. *Id*. The mere fact that Section 4.01 references Suzanne’s objectives means nothing when the Trust explicitly states that “[a]ll provisions of this agreement are to be construed to accomplish these objectives.” *Id*. at 10. Given this reality, literally every provision in the Trust is expressly intended to achieve Suzanne’s objectives. Surely, this does not mean that every individual implicated by a given provision has entered a fiduciary relationship with Suzanne.

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Though not argued by the parties, I also considered the provision of the Texas Trust Code that mentions trust protectors and their fiduciary duty. Section 114.0031(a)(1) of the Texas Trust Code states: “‘Advisor’ includes protector.” TEX. PROP. CODE § 114.0031(a)(1). Section 114.0031(e) then provides:

If the terms of a trust give a person the authority to direct, consent to, or disapprove a trustee’s actual or proposed investment decisions, distribution decisions, or other decisions, the person is an advisor. An advisor is a fiduciary regardless of trust terms to the contrary except that the trust terms may provide that an advisor acts in a nonfiduciary capacity if:

(1) the advisor’s only power is to remove and appoint trustees, advisors, trust committee members, or other protectors; and

(2) the advisor does not exercise that power to appoint the advisor’s self to a position described by Subdivision.

*See* TEX. PROP. CODE § 114.0031(e). This seems to be the only provision in the Texas Trust Code that discusses the fiduciary duty owed by a trust protector. Notably, the section discusses the trust protector in his role as advisor to the trustee. This suggests that the fiduciary relationship is between Stein (Trust Protector) and Avi (Trustee)— again, or perhaps, between Stein (Trust Protector) and the Trust itself. In other words, Texas law does not create a formal fiduciary relationship between Stein and Suzanne.

## **Restrictions On Marriage**

. Parents do not always approve of a child’s choice of spouse. Such was the case in In re Estate of Connolly, 2019 WL 1643856 (Va. Cir. Ct. April 16, 2019) where:

Mr. Connolly, predeceased by Mrs. Connolly, executed his Last Will and Testament on September 29, 1998 (“the Will”), Mr. Connolly owned and resided in a house located in Alexandria and devised this house to his daughter Susan “for as long as she desires to live there” and further provided:

Upon [Susan's] death or upon her cessation of living on the premises or any time she chooses to sell the house, the house shall be sold and the net proceeds of such sale shall be divided equally among my surviving children, except that the share which I bequeath to my son, Kevin Brian Connolly, shall not be distributed to him if he is married to the same person he is married to on the date of the execution of this will. Said share shall be divided equally among my surviving children.

The court had no trouble ascertaining the intent of the provision:

The language of the Will conclusively shows Mr. Connolly's intent for Kevin to divorce Francine. First, Mr. Connolly clearly refers to Francine when he writes: “if [Kevin] is married to the same person he is married to on the date of the execution of this will” because Kevin was married to Francine at the time Mr. Connolly signed the Will and the evidence presented showed that Mr. Connolly was aware of their marriage at this time. Second, “no longer married” clearly expresses his intent for them to divorce. Further, the depositions of Kevin and Father Donahue, the family's priest, show that Mr. Connolly adamantly opposed Kevin's marriage to Francine because he did not attend their wedding and repeatedly expressed his contempt for Francine after they married. Therefore, under the facts of this case, I find that Mr. Connolly, through his Will, explicitly encouraged Kevin to divorce his wife.

Accordingly, the provision was invalid:

While there is no Virginia common law addressing the validity of will provisions that encourage divorce, there exists strong precedent against wills containing absolute prohibitions of marriage. See, e.g., Meek v. Fox, 88 S.E. 161, 163 (Va. 1916) (“It has, by numerous decisions of this court, been held that any contract or provision in general or total restraint of marriage is against the policy of the laws of this state, and this view, it appears, has been uniformly taken wherever the question has arisen.”); Maddox v. Maddox, 52 Va. (11 Gratt.) 804, 807 (1854) (“[N]ot only should all positive prohibitions of marriage be rendered nugatory, but all unjust and improper restrictions upon it should be removed, and all undue influences in determining the choice of the parties should be carefully suppressed.”). Further, Virginia courts have long held that provisions in contracts that encourage divorce are prohibited as against public policy. See, e.g., Capps v. Capps, 216 Va. 378 (1975); Shelton v. Stewart, 193 Va. 162 (1951). Courts in other states have also deemed that absent a testator's intent to protect the beneficiary, a provision in a will encouraging divorce violates public policy. See, e.g., Hall v. Eaton, 259 Ill. App. 3d 319 (4th Dist. 1994). Taking the next logical step, this Court finds that a stipulation in a will that encourages a devisee to divorce his or her spouse, absent an intent to financially protect the devisee, is as loathsome as an absolute prohibition on marriage and therefore violates public policy.

In Rotert v. Stiles, 159 N.E.3d 46 (In. App. 2020), mom left the share to her son, Roger Rotert, outright if he were unmarried at her death, but in trust if her were married. He was married. The court held that the provision was void as a condition restraining marriage.

Interestingly, the opinion suggests another formulation might have altered the result. Suppose mom’s share for Rotert went in trust but distributions would only be made to him when he was unmarried. Perhaps that would be a limitation, not a condition. The opinion notes:

However, Indiana's jurisprudence has distinguished a “condition” restraining marriage from a “limitation” of a bequest or devise on the basis of the recipient's marriage status. [Id. at 777](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=2011178540&pubNum=0000578&originatingDoc=Iba1b330017bb11eb8cddf39cfa051b39&refType=RP&fi=co_pp_sp_578_777&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_578_777). In [Hibbits v. Jack, 97 Ind. 570, 577 (Ind. 1884)](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1884017692&pubNum=0000440&originatingDoc=Iba1b330017bb11eb8cddf39cfa051b39&refType=RP&fi=co_pp_sp_440_577&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_440_577), our supreme court held that a devise of land to the testator's wife “so long as she shall remain my widow” did not contain a condition in restraint of marriage, but rather a mere limitation. Prior to arriving at this conclusion, the court discussed the differences between conditions in restraint of marriage, which are void, and mere limitations, which are not void:

The only general rule, perhaps, in determining whether words are words of condition or of limitation, is that, where they circumscribe the continuance of the estate, and mark the period which is to determine it, they are words of limitation; when they render the estate liable to be defeated, in case the event expressed should arise before the determination of the estate, they are words of condition.

[Id. at 575](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1884017692&pubNum=0000440&originatingDoc=Iba1b330017bb11eb8cddf39cfa051b39&refType=RP&fi=co_pp_sp_440_575&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_440_575).

In [Summit, 9 N.E. at 583-84](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1886008822&pubNum=0000577&originatingDoc=Iba1b330017bb11eb8cddf39cfa051b39&refType=RP&fi=co_pp_sp_577_583&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_577_583), the supreme court concluded that a devise in which the husband willed to his wife “all [his] estate, both real and personal, as long as she remain[ed] [his] widow,” involved words of limitation, not words of condition which would have been treated as a void restraint of marriage. In arriving at this conclusion, the court considered the following:

Words of limitation mark the period which is to determine the estate; but words of condition render the estate liable to be defeated in the intermediate time, if the event expressed in the condition arises before the determination of the estate, or completion of the period described by the limitation. The one specifies the utmost time of continuance, and the other makes some event, which, if it takes place in the course of that time, will defeat the estate.

[Id. at 583](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1886008822&pubNum=0000577&originatingDoc=Iba1b330017bb11eb8cddf39cfa051b39&refType=RP&fi=co_pp_sp_577_583&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_577_583). In reliance on [Hibbits](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1884017692&pubNum=0000440&originatingDoc=Iba1b330017bb11eb8cddf39cfa051b39&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) and [Summit](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1886008822&pubNum=0000577&originatingDoc=Iba1b330017bb11eb8cddf39cfa051b39&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)), the court held in [Thompson v. Patten, 70 Ind.App. 490, 123 N.E. 705, 705-06 (1919)](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1920101913&pubNum=0000577&originatingDoc=Iba1b330017bb11eb8cddf39cfa051b39&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)), that, the provision, stating with respect to a devise of land to the testator's wife “to be and remain her absolute property as long as she remains my widow,” was a limitation, not a condition in restraint of marriage.

Subsequently, in [Stauffer v. Kessler, 81 Ind.App. 436, 130 N.E. 651, 652 (1921)](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1921108036&pubNum=0000577&originatingDoc=Iba1b330017bb11eb8cddf39cfa051b39&refType=RP&fi=co_pp_sp_577_652&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_577_652), the court again addressed the validity of a provision which stated that the defendant was to receive “real estate for and during the term of natural life; provided, however, that if the said [defendant], who is now a widower, shall marry, then such marriage shall terminate this estate.” Although the court found the provision was valid upon the apparent basis that the condition was contained in a deed of conveyance rather than in a will, all parties in the case conceded that the relevant provision was a condition rather than a limitation. [Id. at 652](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1921108036&pubNum=0000577&originatingDoc=Iba1b330017bb11eb8cddf39cfa051b39&refType=RP&fi=co_pp_sp_577_652&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_577_652).

The dissent would have gone the other way because either son was married, or not, when mom died, so the Will provision could not have restrained his behavior:

By the very terms of that devise, any action Rotert might take with regard to his marriage after the opening of the estate would be inconsequential to the form of his inheritance. Thus, the provision cannot be said to encourage or discourage any behavior from Rotert in a manner that could violate public policy regarding marriage. See [Restatement (Second) of Property, Don. Trans. § 6.1 (1983)](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=0291632526&pubNum=0105636&originatingDoc=Iba1b330017bb11eb8cddf39cfa051b39&refType=TS&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) (Oct. 2020 Update) (“A devise conditioned on the devisee being unmarried at the time of the testator's death is not an illegal restraint on marriage.”). And cf. Estate of Owen, 855 N.E.2d at 611-12 (invalidating as condition encouraging divorce a perpetual rental restriction conditioned on daughter not being married to her husband at whatever time in the future that she wished to rent). I, therefore, cannot agree with the Majority that this Trust provision “simply cannot be interpreted as anything other than an encouragement for Rotert to divorce his wife of almost twenty years upon the opening of the estate ....”

## **Former Beneficiary Has Standing To Challenge a Revocable Trust Under California Law**

. If amendments to a revocable trust made shortly before the settlor dies disinherit a beneficiary, does that individual, as one who is not named in the trust’s final iteration, have standing to challenge the validity of the disinheriting amendments in probate court on grounds such as incompetence, undue influence, or fraud? That was the question before the court in Barefoot v. Jennings, 456 P.3d 447 (Ca. 2020). The California appellate court had concluded that only a currently named beneficiary could petition a court regarding the existence or “internal affairs” of a trust but the Supreme Court disagreed:

Our review concerns whether plaintiff has standing to assert the invalidity of the Trust amendments that left her without an interest in her mother’s trust estate. In concluding that plaintiff does not have standing to challenge the amendments to the Trust, the Court of Appeal suggested that plaintiff relied exclusively on section 17200, subdivision (a), which provides: “Except as provided in Section 15800, a trustee or beneficiary of a trust may petition the court under this chapter concerning the internal affairs of the trust or to determine the existence of the trust.” Section 15800 generally provides that so long as the trust remains revocable (that is, as long as the settlor is alive) and the settlor is competent, the settlor, “and not the beneficiary, has the rights afforded beneficiaries under this division.” (Id., subd. (a); see Estate of Giraldin, supra, 55 Cal.4th at p. 1066, 150 Cal.Rptr.3d 205, 290 P.3d 199.) Here, the settlor (Maynord) has died, so section 15800 is no longer relevant.

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The applicable Probate Code provisions support plaintiff’s standing to challenge the merits of the Trust amendments on the grounds of incompetence, undue influence, or fraud. Section 17200, subdivision (a), authorizes a beneficiary to petition the court concerning the trust’s affairs “or to determine [its] existence.” Section 17200, subdivision (b)(3) contemplates the court’s determination of “the validity of a trust provision.” Plainly, the term “trust provision” incorporates any amendments to a trust. Section 24, subdivision (c) defines a “beneficiary” for trust purposes, as “a person who has any present or future interest, vested or contingent.” Assuming plaintiff’s allegations are true, she has a present or future interest, making her a beneficiary permitted to petition the probate court under section 17200.

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Reading the Probate Code section consistent with the statutory scheme as a whole, and examining the statutory language to give it commonsense meaning, we conclude that claims that trust provisions or amendments are the product of incompetence, undue influence, or fraud, as is alleged here, should be decided by the probate court, if the invalidity of those provisions or amendments would render the challenger a beneficiary of the trust. (See Coalition of Concerned Communities, Inc. v. City of Los Angeles (2004) 34 Cal.4th 733, 737, 21 Cal.Rptr.3d 676, 101 P.3d 563 [courts should not examine statutory language in isolation].) So when a plaintiff claims to be a rightful beneficiary of a trust if challenged amendments are deemed invalid, she has standing to petition the probate court under section 17200.

Defendants argue that interpreting section 17200 to permit purported beneficiaries to challenge a trust or its amendments would “invite chaos” because it would permit individuals with no present interest in the trust to “meddle” with its administration. We think defendants overstate the matter. Our holding does not allow individuals with no interest in a trust to bring a claim against the trust. Instead, we permit those whose well-pleaded allegations show that they have an interest in a trust — because the amendments purporting to disinherit them are invalid — to petition the probate court.

A somewhat similar issue was presented in Ferguson v. Ferguson, 167 Idaho 495 (Id. 2020), which the opinion describes as follows:

This case addresses the fiduciary duties of a trustee who has discretion to spend the trust's principal, the scope of records available to a trust beneficiary under Idaho Code section 15-7-303, and the enforceability of a trust instrument's no-contest provision. Michael D. Ferguson was initially excluded as a beneficiary from his parents’ marital trust (the Original Trust). Years later, Michael Ferguson's mother, Sybil Ferguson, essentially reversed Michael Ferguson's exclusion by exercising a power of appointment in her will, designating Michael Ferguson as a beneficiary of the Survivor's Trust—a sub-trust of the Original Trust. When Sybil Ferguson died, Michael Ferguson petitioned the magistrate court for financial records, including records from the Original Trust, to determine whether he would receive his full share of the Survivor's Trust. The parties filed cross-motions for summary judgment, which the magistrate court denied in part and granted in part. Both parties appealed to the district court. The district court affirmed the magistrate court's decision in part and reversed in part. The district court held that the magistrate court erred in concluding that Michael Ferguson did not become a beneficiary of the Survivor's Trust until his mother's death, concluding that he became a beneficiary the moment his mother named him as a beneficiary more than one year before her death. Further, the district court held that the magistrate court erred in refusing to apply the Original Trust's no-contest provision, removing Michael Ferguson as a beneficiary. We reverse the district court's decision.

Interestingly, the power of appointment was exercised in Sybil Ferguson’s Will; the court held that Michael became a beneficiary when the Will was executed not when it was probated or at Sybil’s death. The opinion states:

The district court failed to consider the implications of its prior holding regarding *when* Michael Ferguson became a beneficiary of the Survivor's Trust. The district court held that Michael Ferguson became a beneficiary of the Survivor's Trust on October 3, 2013, when Sybil Ferguson exercised the power of appointment in her Will. Based on that holding, Michael Ferguson was a beneficiary of the Survivor's Trust for approximately eighteen months before Sybil Ferguson's death on May 23, 2015. During this eighteen-month period, Michael Ferguson had the same rights as other beneficiaries in the Survivor's Trust, including the right to seek relevant records and information about the assets and particulars of the Survivor's Trust's administration. *See* I.C. § 15-7-303(b). “[A]ny beneficiary can maintain a suit against the trustee to enforce the duties of the trustee to him[.]” *Beaudoin*, 151 Idaho at 705, 263 P.3d at 759 (quoting *Restatement of Trusts* § 214 cmt. a). Thus, Michael Ferguson *did* have rights that he could enforce in the Survivor's Trust before Sybil Ferguson's death. We acknowledge that Sybil Ferguson had the discretion to spend Survivor's Trust's assets as she pleased, however, that did not relieve her of fiduciary duties imposed on her by statute, nor did it diminish Michael Ferguson's rights as a beneficiary. Thus, the district court erred in concluding that Michael Ferguson had no rights in Sybil Ferguson's estate before Sybil Ferguson's death.

More generally, the court held that a beneficiary has rights throughout the term of a trust:

To begin with, it is important to understand that the Survivor's Trust became irrevocable upon the death of Roger Ferguson. Section 5.01 of the Trust Agreement stated: “Upon the death of the first Grantor to die, the Trust shall become irrevocable.” Article I of the Trust Agreement defined the term “Trust” to mean the Ferguson Family Revocable Trust as a whole, which included the Survivor's Trust as one of the sub-trusts that was created. With this understanding in mind, we turn to the district court's decisions.

The district court erred in concluding that Sybil Ferguson's discretion to spend Survivor's Trust assets during her lifetime meant that she owed no fiduciary duties to beneficiaries. The Trust Agreement gave Sybil Ferguson discretion to distribute and use the Survivor's Trust principal for “any reason.” However, even where a trustee maintains discretion to spend the trust's assets, like Sybil Ferguson in this case, the trustee, is still subject to basic fiduciary duties.

The Restatement (Third) of Trusts contemplates this scenario when analyzing the enforcement and construction of “discretionary interests.” Restatement (Third) of Trusts § 50 (2003). Courts will not interfere with a trustee's exercise of discretionary power when that exercise is reasonable and based on a proper interpretation of a trust's terms. Id. § 50 cmt. b. However, courts will not permit abuse of discretion by the trustee. Id. “What constitutes an abuse depends on the terms of the trust, as well as on basic fiduciary duties and principles.” Id. (emphasis added). The Restatement suggests that the basic fiduciary duties relevant to abuse of trustee discretion include, “(i) the general duty to act, reasonably informed, with impartiality among the various beneficiaries and interests and (ii) the duty to provide the beneficiaries with information concerning the trust and its administration.” Id. (emphasis added and internal citations omitted). Even under the broadest grant of trustee discretion—giving trustees “absolute,” “unlimited,” or “sole” discretion—the trustee must act honestly and avoid acting in bad faith for a purpose other than to accomplish the purposes of the discretionary power. Id. § 50 cmt. c. Thus, while the Restatement generally permits trustees to operate with wide discretionary authority—even where the trustee is also a beneficiary—that discretion does not absolve a trustee of all basic fiduciary duties. Thus, the district court erred in concluding that Sybil Ferguson's “significant discretion” to spend Survivor's Trust assets relieved her of all fiduciary duties.

Second, the district court improperly narrowed Sybil Ferguson's fiduciary duties to those provided in the Trust Agreement. When analyzing Sybil Ferguson's fiduciary duties, the district court only considered her duties under the Trust Agreement. The district court failed to consider the full scope of Sybil Ferguson's fiduciary duties under Idaho trust law.

Whether a fiduciary relationship exists is a question of law, over which this Court exercises free review. Beaudoin v. Davidson Trust Co., 151 Idaho 701, 705, 263 P.3d 755, 759 (2011). It is contrary to sound public policy to permit a grantor to relieve a trustee of all accountability. Restatement (Third) of Trusts § 50 cmt. c. Generally, a “trustee has a duty to administer the trust diligently and in good faith, in accordance with the terms of the trust and applicable law.” Restatement (Third) of Trusts § 76 (2007) (emphasis added). “A trustee has both (i) a duty generally to comply with the terms of the trust and (ii) a duty to comply with the mandates of trust law except as permissibly modified by the terms of the trust.” Id. § 76 cmt. b (emphasis added). Thus, when analyzing Sybil Ferguson's potential duties in administering the Survivor's Trust, we consider: (1) the terms of the Trust Agreement; and (2) the mandates of Idaho trust law.

In Idaho, trustee duties are not limited to those stated in a trust agreement. Idaho trust law recognizes trustee duties in statute and the common law. While Sybil Ferguson enjoyed broad discretion under the Trust Agreement, she was still required to adhere to statutory and common law duties as the Survivor's Trust's sole trustee. For example, Idaho Code section 15-7-303 imposes a duty on trustees to keep the beneficiaries of the trust reasonably informed of the trust and its administration. Upon reasonable request, trustees are required to provide beneficiaries with “relevant information” about the assets of the trust or a “statement of the accounts” of the trust. I.C. § 15-7-303(b), [(c)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000007&cite=IDSTS15-7-303&originatingDoc=I8bdde3e0fed711ea90aaf658db4bc3dc&refType=SP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_4b24000003ba5). Further, at common law, this Court has recognized that a “trustee owes a duty to the beneficiary to administer the trust in the interest of the beneficiaries alone, and to exclude from consideration his own advantages and the welfare of third persons. This duty is called the duty of loyalty.” Taylor v. Maile, 142 Idaho 253, 260, 127 P.3d 156, 163 (2005) (quoting Edwards v. Edwards, 122 Idaho 963, 969, 842 P.2d 299, 305 (Ct. App. 1992)) (internal quotation marks omitted). Thus, Sybil Ferguson still owed the beneficiaries statutory and common law duties, even though those duties were not spelled out in the Trust Agreement. Accordingly, the district court erred by examining Sybil Ferguson's duties solely through the lens of the Trust Agreement.

Third, the district court erroneously concluded that Michael Ferguson had no rights in Sybil Ferguson's estate before her death. The district court cited [Beaudoin](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=2026427593&pubNum=0004645&originatingDoc=I8bdde3e0fed711ea90aaf658db4bc3dc&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) for the proposition that although a beneficiary can maintain a suit against the trustee to enforce the duties that a trustee owes him, it does not impose specific duties upon a trustee. Because the Trust Agreement did not impose a duty on Sybil Ferguson to preserve the Survivor's Trust assets during her lifetime, the district court held that Michael Ferguson's status as a beneficiary did not afford him any rights to enforce from before Sybil Ferguson's death. We disagree.

So, a beneficiary of a marital trust or a credit shelter trust may sue a surviving spouse’s estate for the actions taken as trustee after the surviving spouse’s death. At such time, the surviving spouse may not exercise a power of appointment as might be likely if such a suit were brought during lifetime. Will an in terrorem clause suffice? Perhaps not. Here, the opinion notes:

Michael Ferguson contends that the district court erred in applying and enforcing the Trust Agreement's forfeiture provision. Section 20.03 of the Trust Agreement contains a forfeiture provision that lists various impermissible legal challenges to the sub-trusts and Trust Agreement that would result in a beneficiary forfeiting his interest. The provision reads:

If any beneficiary of this Trust or any trust created under this Trust Agreement, alone or in conjunction with any other person or entity, engages in any of the following actions, the right of the beneficiary to take any interest given to the beneficiary under this Trust or any trust created under this Trust Agreement shall be determined as it would have been determined as if the beneficiary predeceased the last Grantor to die without leaving any surviving descendants: ... (c) files suit on a creditor's claim filed by the beneficiary in a probate [sic] of the estate of either Grantor, against the Trust estate or any Document, after rejection or lack of action by the applicable fiduciary[.]

This type of provision is commonly referred to as a “no-contest” provision. Restatement (Third) of Trusts § 96 cmt. a (2012).

When Michael Ferguson filed his Petition for Allowance of Claim and for Stay against Sybil Ferguson's estate in Arizona probate court, the Successor Trustees filed a counterclaim for declaratory judgment in this case, arguing that Michael Ferguson's Arizona petition triggered the Trust Agreement's forfeiture provision. In other words, the Successor Trustee argued that Michael Ferguson forfeited his interest in the Survivor's Trust by filing the Arizona petition. The magistrate court held that the forfeiture provision was not triggered by Michael Ferguson's Arizona petition because Michael Ferguson only filed the claim as a “placeholder,” rather than as a challenge to the validity of the Original Trust. Relying on its erroneous prior conclusion that Sybil Ferguson did not owe Michael Ferguson any fiduciary duties, the district court reversed the magistrate court. Specifically, the district court held that because Sybil Ferguson owed no fiduciary duty, it would not be reasonable for Michael Ferguson to conclude he was entitled to an accounting from before Sybil Ferguson's death or that she breached any fiduciary duties as sole trustee of the Survivor's Trust. As such, the district court held that Michael Ferguson lacked “probable cause” to bring his Arizona petition, meaning that he forfeited his interest as a beneficiary in the Survivor's Trust.

\* \* \*

Accordingly, we adopt the majority position identified in the Restatement, and hold that no-contest provisions are generally enforceable in Idaho trust instruments. Further, although no-contest provisions are generally enforceable, their enforceability is subject to various common law limitations.

\* \* \*

At the outset, Michael Ferguson's Arizona petition does fall within the scope of the Trust Agreement's forfeiture provision. Sub-section (c) of the forfeiture provision is triggered when a beneficiary files suit on a creditor's claim in a Grantor's probate estate. Michael Ferguson's Arizona petition sought to litigate his creditor's claim against Sybil Ferguson's (an original Grantor) estate in Arizona probate court. Thus, on its face, Michael Ferguson's creditor's claim falls within the scope of sub-section (c) of the Trust Agreement's forfeiture provision.

Notwithstanding, the forfeiture provision is not enforceable because it interferes with the enforcement and proper administration of the trust. See Restatement (Third) of Trusts § 96(2). As trustees of the Survivor's Trust, the Successor Trustees have a duty to keep the Survivor's Trust beneficiaries reasonably informed of the trust and its administration. See I.C. § 15-7-303. Upon reasonable request, the Successor Trustees must provide beneficiaries with relevant information about the assets of the trust and particulars relating to its administration. Id. § 303(b). Here, the Successor Trustees refused to provide Michael Ferguson with relevant information that he requested pursuant to his rights as a beneficiary under Idaho Code section 15-7-303(b). Instead of producing the information, the Successor Trustees sought to prevent Michael Ferguson from obtaining the information through the forfeiture provision. Put differently, the Successor Trustees are attempting to use the forfeiture provision to remove Michael Ferguson as a beneficiary as a penalty for his seeking records pertaining to the manner in which the Survivor's Trust has been administered. Such a result is inconsistent with the proper administration of the Survivor's Trust under Idaho law, and interferes with Michael Ferguson's rights as a beneficiary in the Survivor's Trust. Accordingly, the district court erred in enforcing the forfeiture provision.

The Successor Trustees argue that the forfeiture provision cannot interfere with the proper administration of the Survivor's Trust because Michael Ferguson's argument overlooks Article Eight and section 18.05 of the Trust Agreement. Further, the Successor Trustees argue that the forfeiture provision should be enforced because Michael Ferguson failed to demonstrate probable cause for filing the Arizona petition. We address these arguments in turn.

The Successor Trustees argue that the forfeiture provision cannot interfere with administration of the Survivor's Trust because Article Eight granted Sybil Ferguson “virtually unlimited discretion” in using Survivor's Trust assets. The Successor Trustees further argue, because Sybil Ferguson enjoyed unlimited discretion, she did not owe Michael Ferguson any fiduciary duties. Essentially, the Successor Trustees argue that the forfeiture provision cannot interfere with the Survivor's Trust administration because Michael Ferguson is not entitled to the records he seeks. This argument misses the mark. First, as stated above, Sybil Ferguson did owe some limited fiduciary duties as sole trustee of the Survivor's Trust. Second, Sybil Ferguson's discretion to spend Survivor's Trust assets during her lifetime has no bearing on the Successor Trustees’ current fiduciary duties to Survivor's Trust beneficiaries. Thus, Sybil Ferguson's discretion to spend Survivor's Trust assets during her lifetime did not alter or impact the Survivor's Trust's current administration.

Further, the Successor Trustees argue that the forfeiture provision cannot interfere with proper administration of the Survivor's Trust because section 18.05 of the Trust Agreement relieves any successor trustees from liability for previous trustees’ acts, omissions, or forbearance. Section 18.05 provides:

No successor [t]rustee is obligated to examine the accounts, records, or actions of any previous [t]rustee, the personal representative of the estate of a deceased Grantor, or any other previous fiduciary. No successor [t]rustee shall be held responsible for any act, omission, or forbearance by any previous [t]rustee or by the personal representative of the estate of a deceased Grantor or any other previous fiduciary.

Section 18.05 is an exculpatory provision that relieves the Successor Trustees from liability for Sybil Ferguson's actions as trustee. However, this exculpatory provision does not relieve the Successor Trustees from their current fiduciary duties, nor does it mean that they can ignore a beneficiary's request for relevant records pursuant to Idaho Code section 15-7-303(b).

Additionally, the Successor Trustees argue that the forfeiture provision is enforceable because Michael Ferguson lacked probable cause in filing his creditor's claim in Arizona probate court. The probable cause requirement is a limitation on the enforceability of no-contest provisions. Restatement (Third) of Trusts § 96 cmt. e. The Restatement provides that no-contest provisions are enforceable “unless probable cause existed for instituting the proceeding.” Id. The Restatement defines probable cause as evidence that, at the time of instituting the proceeding, “would lead a reasonable person, properly informed and advised, to conclude that there was a substantial likelihood that the challenge would be successful.” Restatement (Third) of Property (Wills and Donative Transfers) § 8.5 cmt. c. Like no-contest provisions, Idaho has never considered whether lack of probable cause is a requirement to enforce a no-contest provision.

Because the forfeiture provision interferes with the proper administration of the Survivor's Trust, we decline to consider whether Michael Ferguson had probable cause to bring the Arizona petition. Two facts from the record support our decision. First, Michael Ferguson filed the Arizona petition approximately ten months after filing his initial petition here. In that ten-month period, the Successor Trustees refused to provide any information regarding Survivor's Trust allocations that would allow Michael Ferguson to determine whether the Survivor's Trust received an appropriate share of the available assets. Thus, the Successor Trustees attempted to enforce the forfeiture provision while withholding critical information in determining the proper administration of the Survivor's Trust. Second, Michael Ferguson's Arizona petition was necessary to preserve his creditor's claim in Arizona probate court. Arizona has a two-year statute of limitations for claims against a decedent's estate. ARIZ. REV. STAT. § 14-3803(A)(1). A claimant must file his claim within two years after the decedent's death. Id. Sybil Ferguson died on May 23, 2015, and Michael Ferguson first notified Sybil Ferguson's estate of his claim on March 16, 2017. At that point, Michael Ferguson had approximately two months to file his claim to comply with the Arizona statute. Further, once a claim is disallowed by the personal representatives of the estate, the claimant has sixty days to file a petition in the probate court to preserve his claim. ARIZ. REV. STAT. § 14-3806(A). The co-representatives disallowed Michael Ferguson's initial claim on May 4, 2017. Thus, Michael Ferguson had to petition the probate court within sixty days, or risk losing any potential claim against Sybil Ferguson's estate.

## **Charitable Trust Beneficiary Standing**

. The Maine version of the Uniform Trust Code grants standing to a charitable beneficiary that is a “qualified beneficiary.” A charity is a designated beneficiary if it is “expressly designated to receive distributions” under the trust and, on the relevant date is a distributee or permissible distributee of income or principal. At issue in Attorney General v. Sanford, 225 A.3d 1026 (Me. 2020), was whether this permissive language made the charity “expressly designated”:

All or any part of the net income and principal may be paid for the charitable purposes of 1) providing educational and scientific study of ant[iq]ue automobiles, whether owned by the trust or any other charitable organization, and other methods of transportation, 2) providing for the display to the public of antique automobiles, whether owned by the trust or any other charitable organization, and 3) maintaining in suitable condition for public display and study any antique automobiles owned by the trust or any other charitable organization.

In furtherance of the foregoing purposes the Trustee may, without limitation, sell such automobiles as he from time to time deems necessary or advisable, whether to provide a suitable endowment to maintain the Collection or to permit the continued display of antique automobiles by Seal Cove Auto Museum or by any other museum[;] ... loan all or any part of the Collection to museums, including without limitation Seal Cove Auto Museum, or other charitable organizations ... for public display or study; permit access to the Collection for educational purposes by scholars or students; and generally do all such acts as may be necessary or appropriate to educate the public with respect to antique automobiles and to make the Collection available for public viewing.

Holding that “expressly designated” does not mean “mandatory,” the opinion states:

We now consider whether Seal Cove is “expressly designated to receive distributions under the terms of” the Trust. Id. § 110(1). In particular, we must determine whether a charitable organization satisfies this requirement by showing that it is expressly permitted to receive distributions from the trust or whether a charitable organization must show that it is expressly mandated to receive distributions from the trust. Because the Declaration of Trust expressly authorizes the Trustees to make distributions to Seal Cove, but does not require them to do so, the resolution of this appeal turns on the meaning of the word “designated.”

In statutory interpretation, we first examine “the plain meaning of the statutory language in the context of the whole statutory scheme.” Sunshine v. Brett, 2014 ME 146, ¶ 13, 106 A.3d 1123. “Only if the statutory language is ambiguous—that is, reasonably susceptible to more than one interpretation—will we consider other indicia of legislative intent.” [Id.](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=2035069189&pubNum=0004578&originatingDoc=I82ec4b0043ca11eaa21cb04c67e0c07f&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation))

The meaning of 18-B M.R.S. § 110(1) is established when it is compared to section 103(12), which articulates the definition of a qualified beneficiary of a private trust. Title 18-B M.R.S. § 103(12) states:

“Qualified beneficiary” means a living beneficiary who on the date the beneficiary's qualification is being determined:

**A.** Is a distributee or permissible distributee of trust income or principal;

**B.** Would be a distributee or permissible distributee of trust income or principal if the interests of the distributees described in paragraph A terminated on that date, but the termination of those interests would not cause the trust to terminate; or

**C.** Would be a distributee or permissible distributee of trust income or principal if the trust terminated on that date.

Title 18-B M.R.S. § 110(1) similarly provides:

A charitable organization expressly designated to receive distributions under the terms of a charitable trust has the rights of a qualified beneficiary under this Code if the charitable organization, on the date the charitable organization's qualification is being determined:

**A.** Is a distributee or permissible distributee of trust income or principal;

**B.** Would be a distributee or a permissible distributee of trust income or principal upon the termination of the interests of other distributees or permissible distributees then receiving or eligible to receive distributions; or

**C.** Would be a distributee or permissible distributee of trust income or principal if the trust terminated on that date.

The Legislature's use of nearly identical language in sections 103(12)(A)-(C) and 110(1)(A)-(C) demonstrates its intent that a charitable organization may assert the rights of a qualified beneficiary only if it has a beneficial interest in a charitable trust equal to that of a qualified beneficiary of a private trust. Cf. Great N. Nekoosa Corp. v. State Tax Assessor, 675 A.2d 963, 967-68 (Me. 1996)(Clifford, J., dissenting) (citing Sullivan v. Stroop, 496 U.S. 478, 484, 110 S.Ct. 2499, 110 L.Ed.2d 438 (1990)) (“Identical words in different parts of the same statute are presumed to have the same meaning.” (emphasis omitted)). Thus, a charitable organization does not need to show that the terms of the trust make it a mandatory distributee in order to satisfy the “expressly designated” requirement.

Our reading of section 110(1) comports with the canon of statutory interpretation that “[w]ords in a statute ... be given meaning and not treated as meaningless and superfluous.” Wong v. Hawk, 2012 ME 125, ¶ 8, 55 A.3d 425. Reading the word “designated” as “mandated” would eviscerate the phrase “or permissible distributee” as it is used in section 110(1)(A) because a charitable organization that is expressly mandated to receive distributions under the terms of the trust would not be a “permissible distributee,” but simply a “distributee.” We will not interpret a statute in such a way as to render some words meaningless. See id.

The Commentary to the UTC suggests the opposite result but the court expressly ignored it:

The Trustees argue that Uniform Trust Code commentary to section 110 supports their interpretation of the word “designated.” That commentary states that to have the rights of a qualified beneficiary, a charitable organization “must be named in the terms of the trust and must be designated to receive distributions,” and therefore “excluded are organizations who may receive distributions only in the trustee's discretion ....” 18-B M.R.S.A. § 110 Unif. Trust Code cmt. (2012). The Trustees argue that this shows that the word “designated” must be read to mean “mandated.”

This argument fails because the plain language of section 110(1), as adopted by the Legislature, unambiguously provides a different directive. The language used by the Legislature gives Seal Cove the rights of a qualified beneficiary. The commentary to the UTC is not part of the statute and cannot create an ambiguity where none exists. See Sunshine, 2014 ME 146, ¶ 13, 106 A.3d 1123.

In Hadassah v. Melcer, 268 So.3d 759 (Fl. App. 2019), the court found that Hadassah was a qualified beneficiary where the trust provided:

The trust was created in 1989 by Sylvia Gelt. The trust instrument provided that upon her death, a portion of the trust fund was to be placed in a Credit Shelter Trust for her husband, Samuel. Upon his death, the balance of the Credit Shelter Trust was to be divided into three separate trusts for the benefit of their daughters.

During their lifetimes, the daughters have the right to receive income and principal distributions from their respective trusts. They do not have general or testamentary powers of appointment over any portion of the principal or undistributed income of their respective trusts.

The trust instrument provides that upon the death of each daughter, her trust terminates and the balance of the principal and any undistributed income is redistributed to the trust(s) of the remaining living daughter(s). When the last daughter dies, the trust terminates and the trustee is instructed to distribute the remaining principal and undistributed income to three named charities.

## **Declaratory Judgment Action Does Not Trigger No Contest Clause**

. At issue in Hunter v. Hunter, 838 S.E.2d 721 (Va. 2020), was whether Chip, a beneficiary of a trust known as Theresa’s Trust, triggered a no contest clause by filing an action questioning the inform and report provisions of the trust. Eleanor, the trustee, argued yes. The complaint that Chip filed had two counts the court described as follows:

Chip filed this declaratory judgment action, seeking a favorable interpretation of the trust that would require Eleanor to provide Chip with information and documents related to the trust. Aware of the no-contest provision in the Theresa Trust, Chip divided his declaratory judgment complaint into two carefully worded counts. Count II acknowledged the ultimate goal of the litigation by asserting that Chip sought the “determination of the rights of Chip and Eleanor” under the terms of the Theresa Trust to require the trustee to inform and report under Code § 64.2-775, other various provisions of the Virginia Uniform Trust Code, or stand-alone principles of common law and equity jurisprudence. The rationale behind Count II, as Chip explained to the circuit court in a subsequent brief, was that he interpreted the language of the inform-and-report waiver provision to only apply to the duty to inform and report under former Code § 55-548.13 and to have no effect on what he interpreted as freestanding inform-and-report duties arising under other sources of law. See R. at 177-85. Based upon prior communications with Eleanor’s counsel, Chip understood Eleanor’s position to be that the waiver provision relieved her of any and all inform-and-report duties.

The complaint expressly sought to create a firewall protecting Count I from any uninvited, premature consideration of Count II. Prior to the complaint’s allusion to the competing interpretations of the inform-and-report waiver provision, Count I requested that the circuit court “initially determine” whether determining Chip’s and Eleanor’s rights and duties under the trust “would constitute a ‘contest’ ” under the no-contest provision, thereby triggering the forfeiture of Chip’s beneficial interest in the trust. J.A. at 3. Count I stated that the court should consider the request in Count II “if, and only if,” the court interpreted the no-contest provision to be inapplicable. Id. Relying on our decision in Virginia Foundation of Independent Colleges v. Goodrich, 246 Va. 435, 436 S.E.2d 418 (1993), the complaint insisted that it sought “no further relief than that which has been held by the Virginia Supreme Court ... to permit a beneficiary to file a declaratory judgment action seeking an interpretation ... without such conduct being held to fall within the scope of a no contest clause and/or actuating a no contest clause.” J.A. at 3. In Count I, Chip contended that he “merely [sought] an interpretation of the language of the Trusts with respect to the rights and duties of Chip and Eleanor,” and thus, Count II did not trigger the application of the no-contest clause. Id. at 11.

The no contest clause and the reasoning of the lower court, the opinion summarized this way:

The circuit court held that Count II of the complaint had triggered the no-contest provision and, on this basis, ordered the forfeiture of Chip’s interest in the Theresa Trust. Even if it were true that Count II had violated the no-contest provision, the court erred by disregarding the if-and-only-if proviso of Count I and ordering a forfeiture based upon Count II. Instead, in such a scenario, the circuit court should have entered judgment on Count I in Eleanor’s favor and dismissed Count II as moot.

That said, we do not accept the first premise of the circuit court’s reasoning that Count II violated the no-contest provision. Whether such a violation has occurred “depends upon the wording of the ‘no contest’ provision and the facts and circumstances of each particular case.” Womble, 198 Va. at 529, 95 S.E.2d 213; see also Goodrich, 246 Va. at 439, 436 S.E.2d 418. In the first paragraph of the self-styled “IN TERROREM PROVISION” of the trust, Theresa provided background context explaining her intent:

I have from time to time made gifts and provided financial support to each of my children and to my grandchild as I wished, and as my husband and I determined to be necessary to their circumstances. Except as otherwise expressly set forth in this document, the share for any beneficiary hereunder shall not be affected by any gifts or loans to any beneficiary hereunder.

J.A. at 254. The next paragraph of the no-contest provision begins: “I desire that my children and grandchild not expend resources disputing loans, gifts or bequests that I have made.” Id. (emphasis added). Theresa then sought to enforce that desire by declaring:

Therefore, if any beneficiary under this Trust Agreement takes any one or more actions described in this paragraph, then the interest of such beneficiary under this Trust Agreement shall be revoked, and such beneficiary shall be deemed to have predeceased me without surviving descendants for all purposes under this Trust Agreement, effective as of the date such action is taken.

Id. One of the “actions” triggering the forfeiture was “[c]ontest[ing] any provision of this Trust Agreement.” Id.

The no-contest provision provided a specific definition for a prohibited “contest” of the trust: “For purposes of this Article, a person shall be deemed to contest an instrument or action, if he or she takes any action seeking to invalidate, nullify, set aside, render unenforceable, or otherwise avoid the effect of such instrument, action or transaction.” Id. at 255. A caveat, however, followed this definition:

The preceding paragraph shall take effect regardless of whether such contest is made in good faith or is ultimately successful, provided, however that a petition made in good faith and not objected to by my Trustee hereunder, seeking an interpretation of this or any other instrument, shall not be considered a contest of such instrument.

Id.

Focusing on the sentence defining “contest,” Chip asserts that Count II never sought to “invalidate, nullify, set aside, render unenforceable, or otherwise avoid” any provision of the Theresa Trust. Id. Nor did he violate his mother’s “desire” that no beneficiary should “expend resources disputing loans, gifts or bequests” that she had previously made. Id. at 254. Instead, when properly construed, Count II merely sought an interpretation of the trustee’s inform-and-report duties under other sources of law that would be wholly unaffected by the waiver provision. The circuit court disagreed with Chip and ordered the forfeiture of his interest in the trust. We believe the court erred in doing so.

Eleanor, the trustee, argued that the no contest cause was triggered because she did not agree to the petition. The court flatly rejected that argument stating:

Eleanor acknowledges this general rule but argues that the no-contest provision in the Theresa Trust required forfeiture even if Chip sought only a judicial interpretation of its provisions. Skipping over the sentence defining “contest,” Eleanor lays emphasis on the proviso that follows. That proviso, broken out below for clarity, purports to recognize an exception to the no-contest provision:

• provided, however that a petition

• made in good faith and

• not objected to by my Trustee hereunder,

• seeking an interpretation of this or any other instrument,

• shall not be considered a contest of such instrument.

See J.A. at 255 (emphases added). Eleanor argues that this proviso extends the no-contest provision to a beneficiary’s good faith petition for a judicial interpretation of the trust if she, as trustee, objects to the request. To her, the meaning of the provision is quite clear: A request for a judicial interpretation of the trust constitutes a contest triggering forfeiture so long as she says so. We have several concerns about this argument.

To begin, we have never addressed (much less approved) a no-contest provision seeking to seal the courthouse doors to a litigant seeking an interpretation (rather than an invalidation) of a trust or will provision. Several courts have criticized such an effort as an impermissible overreach inconsistent with the traditional boundaries of no-contest provisions. Leading commentators have taken a similar view.[11](https://1.next.westlaw.com/Document/I8c430330649811eab47fc33bf795b230/View/FullText.html?transitionType=UniqueDocItem&contextData=(sc.UserEnteredCitation)&userEnteredCitation=838+S.E.2d+721#co_footnote_B00112050561435) We need not resolve that question in this case, however, because the proviso Eleanor relies upon merely implies, but does not expressly state, that her mother intended to include a request for judicial interpretation within the definition of a contest, thus warranting a forfeiture. In this area of legal draftsmanship, mere implications will not suffice.

As we noted earlier, forfeiture provisions are “strictly construed,” Rafalko, 290 Va. at 395, 777 S.E.2d 870, because “equity abhors forfeitures,” Jones, 101 U.S. at 628, and because “provisions that require forfeiture are not favored in the law and will not be enforced except according to their clear terms,” Rafalko, 290 Va. at 402, 777 S.E.2d 870. To be effective, the provision must “precisely express” an intent to cause a forfeiture. Keener, 278 Va. at 443, 682 S.E.2d 545. “The instrument must give the right of forfeiture in terms so clear and explicit as to leave no room for any other construction.” Davis, 205 Va. at 169, 135 S.E.2d 812. These canons of construction have great weight in the context of a no-contest provision in a trust instrument since a trust’s very identity as a creature of equity presupposes the possibility of oversight of the trustee by a chancellor jealous of safeguarding the rights of all parties with an interest in the trust.

Strictly construed, the proviso in the no-contest provision of the Theresa Trust does not equate a request for an interpretation of the trust’s provisions with a contest of the trust. Instead, the no-contest provision enumerates the actions constituting a “contest” as “any action seeking to invalidate, nullify, set aside, render unenforceable, or otherwise avoid the effect of such instrument, action or transaction.” J.A. at 255. These verbs — invalidate, nullify, set aside, render unenforceable, and avoid the effect of — are not synonyms for interpret.

The proviso purports to remove an action (a request for judicial interpretation) from a list in which the action never appeared in the first place. The proviso states that Eleanor, as trustee, can agree that a request for an interpretation is not a contest. The proviso thus assumes that a request for an interpretation has already been defined as a “contest” by the no-contest clause — thus creating the need for a proviso that excises “interpretation” from that definition in certain circumstances. By doing so, the proviso makes a tautological assertion “in which the point to be proved is implicitly taken for granted,” Black’s Law Dictionary 189 (11th ed. 2019), a classic example of begging the question. One does not need an exception to a rule to do something the rule does not prohibit.

For these reasons, the principles of strict construction dictate that neither the definition of “contest” nor the proviso’s attempted exception from that definition clearly and unmistakably states that either count of Chip’s declaratory judgment action violates the no-contest provision by seeking an interpretation of the trust and, based thereon, a declaration of the trustee’s duties. The circuit court erred in concluding otherwise.

## **Settlement Agreement Among Trust Beneficiaries Void**

. Roth v. Jelley, 45 Cal.App.5th 655 (Ca.App. 2020), involved a settlement among some, but, crucially, not all of the trust beneficiaries. The opinion reviews the factual background:

Petitioner Mark Roth (Mark) petitioned the probate court to be recognized as the beneficiary of a trust created by his grandfather pursuant to the default distribution provision of his grandfather’ will. The probate court rejected the petition on the ground that an order made in the probate of the grandfather’s estate in 1991 (which we refer to as the “1991 Decree”) eliminated Mark’s interest in the trust and was binding on him, even though he received no notice of the court proceeding that resulted in the 1991 Decree. This appeal presents the question whether Mark had a property interest in the testamentary trust created by his grandfather such that he had a due process right to notice and an opportunity to be heard before the probate court could enter the 1991 Decree that eliminated his interest in the trust.

Mark’s grandfather, McKie Roth Sr. (McKie Sr.) created a trust in his will for the benefit of his wife Yvonne Roth (Yvonne) during her life and granted her a testamentary power of appointment over the remainder. The will provided a default distribution scheme in case Yvonne did not exercise her appointment power, under which McKie Sr.’s three adult children from a prior marriage and the Yvonne’s one adult son from a prior marriage would each take a one-quarter share of the remainder of the trust, with the proviso that, if an adult child did not survive Yvonne, then that child’s surviving issue would take that child’s share per stirpes. Thus, under the will, the issue of each of the four adult children had a contingent remainder interest in the trust, subject to divestment by Yvonne’s exercise of her appointment power.

When McKie Sr. died in 1988, his three adult children raised claims against their father McKie Sr.’s estate unrelated to the trust; they eventually settled their claims with McKie Sr.’s estate, Yvonne (his surviving wife), and the estate executor. One of the terms of the settlement was that the McKie Sr.’s three adult children disclaimed any interest in the trust.

In 1991, the probate court issued a decree of final distribution of the McKie Sr.’s estate—the 1991 Decree—which included language changing the default distribution of the trust upon Yvonne’s death, ostensibly based on the terms of the settlement. The 1991 Decree specified that the remainder of the trust was to be distributed solely to Yvonne’s son or his surviving issue in case of default (i.e., failure of Yvonne to exercise her testamentary power of appointment). But McKie Sr.’s grandchildren (specifically, Mark and the other then-living issue of McKie Sr.’s three adult children) were not given prior notice of the 1991 decree, even though the decree *eliminated* their contingent interests in the remainder of the trust. Yvonne died in 2016 without having exercised her testamentary power of appointment.

Mark’s father McKie Roth Jr. (McKie Jr.) predeceased Yvonne. Mark petitioned the probate court to be recognized as a beneficiary of the trust pursuant to the default distribution provision of McKie Sr.’s will. He asserted the 1991 Decree was void because he never received notice of the proceeding that culminated in the 1991 decree.

At the parties’ agreement, the probate court decided the following dispositive issue in a bifurcated proceeding: was the 1991 Decree binding on the parties? The court determined the 1991 Decree was binding even though Mark received no prior notice because, in the court’s view, Mark had no cognizable property interest in the trust.

We conclude, however, that Mark did have a property interest in the trust in 1991 and that the 1991 Decree adversely affected his interest. Since it is not contested that Mark’s existence and address were reasonably ascertainable at the time, due process required that Mark be given notice of the proceeding that resulted in the 1991 Decree and an opportunity to object. Because Mark was not given such notice, the 1991 Decree is void. Accordingly, we reverse.

[emphasis in original]

Why did the probate court believe Mark was not required to receive notice? Because Mark would not take unless at least two contingencies were met. The Court of Appeals summarizes Mark’s interest as follows:

Mark’s property interest in the FYR Trust was contingent, not vested, because Mark would only take a share of the remainder if certain conditions precedent occurred: McKie Jr. had to predecease Yvonne (“not be then living” upon Yvonne’s death) and Mark had to survive McKie Jr. (“leave issue surviving them”). Further, there had to be some balance left in the trust at its termination and Yvonne had to refrain from using her testamentary power of appointment. Mark’s interest was future, not present, because he could only take a share of the remainder upon Yvonne’s death in the future.

But reaches the opposite conclusion from the probate court:

But we reject the probate court’s determination that Mark “had no more than a unilateral expectation to a share of the [FYR] Trust.” Mark had an actual property interest in the trust as set forth in the MWR Will. Mark’s property interest was contingent and subject to divestiture if Yvonne exercised her testamentary power of appointment, but it was more than a “mere unilateral expectation” as claimed by respondents. First, “[t]he law has long recognized that a contingent future interest is property [citation] no matter how improbable the contingency” (In re Marriage of Brown (1976) 15 Cal.3d 838, 846, fn. 8, 126 Cal.Rptr. 633, 544 P.2d 561), and “a contingent remainder is an estate and not a mere expectancy” (Estate of Zuber (1956) 146 Cal.App.2d 584, 591, 304 P.2d 247). Second, takers in default (i.e., persons specified by a donor of a power of appointment to take property in default of the appointment) hold property interests even though “their interests are subject to complete divestment” through exercise of a power of appointment. (Ammco Ornamental Iron, Inc. v. Wing (1994) 26 Cal.App.4th 409, 418-419, 31 Cal.Rptr.2d 564 [“persons in existence, who are specifically designated in a trust instrument to take in default of the exercise of a power of appointment by the holder of the preceding estate, are beneficiaries of that trust and acquire vested remainder interests, although their interests are subject to complete divestment”]; see § 672, subd (a) [“if the powerholder of a discretionary power of appointment fails to appoint the property, releases the entire power, or makes an ineffective appointment, in whole or in part, the appointive property not effectively appointed passes to the person named by the donor as taker in default”].) Thus, Mark’s contingent future interest in the remainder of the FYR Trust created by the MWR Will upon McKie Sr.’s death was a cognizable property interest, not a mere expectancy, and this property interest did not disappear simply because it was subject to complete divestment if Yvonne chose to exercise her testamentary power of appointment.

The existence of a property interest required notice be given to Mark. The opinion states:

1. Due Process Requires Reasonable Notice of Any Proceeding Adversely Affecting a Property Interest

In 1950, the United States Supreme Court in Mullane v. Central Hanover Bank & Trust Co. (1950) 339 U.S. 306, 314, 70 S.Ct. 652, 94 L.Ed. 865 (Mullane) “recognized that prior to an action which will affect an interest in life, liberty, or property protected by the Due Process Clause of the Fourteenth Amendment, a State must provide ‘notice reasonably calculated, under all circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections.’ ... [T]he Court held that published notice of an action to settle the accounts of a common trust fund was not sufficient to inform beneficiaries of the trust whose names and addresses were known. The Court explained that notice by publication was not reasonably calculated to provide actual notice of the pending proceeding and was therefore inadequate to inform those who could be notified by more effective means such as personal service or mailed notice.” (Mennonite Bd. of Missions v. Adams (1983) 462 U.S. 791, 795, 103 S.Ct. 2706, 77 L.Ed.2d 180 (Mennonite).)

In Mennonite, the United States Supreme Court succinctly stated the rule, “Notice by mail or other means as certain to ensure actual notice is a minimum constitutional precondition to a proceeding which will adversely affect the liberty or property interests of any party ... if [that party’s] name and address are reasonably ascertainable.” (Mennonite, supra, 462 U.S. at p. 800, 103 S.Ct. 2706.)

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Because the 1991 Decree adversely affected Mark’s property interest in the FYR Trust, he was entitled to notice by mail and an opportunity to be heard if his name and address were reasonably ascertainable. (Mennonite, supra, 462 U.S. at pp. 795, 800, 103 S.Ct. 2706.)

At the time the 1991 Decree was adopted, Mark was McKie Jr.’s adult son and McKie Sr.’s grandson, and Jelley had apparently been dealing with disputes with McKie Jr. (and his siblings) for some years. It appears Jelley only had to ask McKie Jr. for the names and addresses of his existing children in order to provide Mark mailed notice. Mark has maintained below and on appeal that his existence and whereabouts were either known or reasonably ascertainable, and respondents do not contest this point. Under these circumstances, we conclude due process required that Mark be given mailed notice of the probate hearing that resulted in the 1991 Decree and an opportunity to object.

Respondents claim that even if Mark had a property interest in the FYR Trust, Mullane does not require actual notice “given the remoteness of his interest.” They rely on the Mullane court’s observation, “Nor do we consider it unreasonable for the State to dispense with more certain notice to those beneficiaries whose interests are either conjectural or future or, although they could be discovered upon investigation, do not in due course of business come to knowledge of the common trustee.” (Mullane, supra, 339 U.S. at p. 317, 70 S.Ct. 652, italics added.) They argue this observation shows Mark was not entitled to mailed notice. We are not persuaded.

First, Mark’s property interest in the FYR Trust was not conjectural. The MWR Will created a contingent future remainder interest in the trust. Second, we do not read Mullane to mean due process notice requirements do not apply to holders of future property interests. In [Mullane](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1950118311&pubNum=0000780&originatingDoc=I3d8c9c30578a11ea851bfabee22f40c8&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)), the appellant was “appointed special guardian and attorney for all persons known or unknown not otherwise appearing who had or might thereafter have any interest in the income of the common trust fund.” (Mullane, supra, 339 U.S. at p. 310, 70 S.Ct. 652, italics added.) In this context, when the court spoke of interests that were “future,” it likely was referring to persons who did not currently have a property interest in the common fund but might acquire an interest in the future, not to beneficiaries who currently had future property interests in the fund. On the other hand, if the court did mean current beneficiaries with future interests were not entitled to mailed notice, the court may have determined that, because the common fund involved 113 trusts (id. at p. 309, 70 S.Ct. 652), it was too burdensome to expect the trustee to attempt to identify all current holders of future interests in the fund; but even if that was the court’s reasoning, it would not apply here since it cannot be said in this case that it would have been burdensome for the trustee to ask the three adult children of McKie Sr. for the names and addresses of their own children. In any event, we do not think the [Mullane](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1950118311&pubNum=0000780&originatingDoc=I3d8c9c30578a11ea851bfabee22f40c8&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) court intended to exclude reasonably ascertainable holders of future property interests from due process considerations.

## **Spousal Election And Revocable Trust – Indiana Law**

. In In the Matter of the Revocable Trust Agreement Created by the Settlor, Anil Kumar Sarkar, Dipa Sarkar v. Anuradha (“Mili”) Sarkar Naugle, 145 N.E.3d 802 (Ind. 2020), the issue presented was whether a surviving spouse can satisfy her election to take against the will of her deceased husband when he transferred the majority of his assets into a revocable trust. The trial court summarized the facts it thought were relevant as follows:

10. [ ] Anil's [T]rust was established in 1993, twenty-two (22) years prior to his death, for the purpose of obtaining assistance in personal and business affairs as well as disposing of his property at death. Anil had check writing authority on his [T]rust and could amend or modify it at any time. Both Anil and Dipa were present with [Attorney Lyman] when the original estate planning advice was provided. The couple agreed to dispose of their assets separately and not to each other. Dipa was aware of Anil's [T]rust and its provisions because it was identical to hers. Further, Anil and Dipa used a joint financial adviser, [ ], who testified that the couple's investments were identical. [The financial advisor] testified that Anil and Dipa came together to her office to execute financial documents and that each was aware of the others IRA and trust.

12. The [c]ourt finds no evidence that Anil's intent in creating the [T]rust was to frustrate Dipa's right to a statutory elective share. The [c]ourt further finds that Anil's [T]rust was not created in contemplation of his death and is therefore not testamentary. Therefore, the [c]ourt finds that Anil's [T]rust assets are not subject to Dipa's statutory elective share.

As stated, the trial court held the surviving spouse could not reach the revocable trust assets. The test in Indiana is intent: did the spouse fund the trust in contemplation of death to negate the other spouse’s rights. The opinion reviews the precedent:

Through Leazenby v. Clinton Co. Bank & Trust, 171 Ind.App. 243, 355 N.E.2d 861 (1976) and its progeny, Indiana precedents have shaped the conditions in which a surviving spouse may reach beyond the will into a valid inter vivos trust to satisfy the statutory elective right when faced with insufficient probate assets.

In [Leazenby](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1976131159&pubNum=0000578&originatingDoc=If1047d306e2511eaafc9a4147037e074&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)), we held that an inter vivos trust established by a wife successfully transferred her property and removed it from the estate, thereby in effect defeating her husband's interest in his statutory elective share. Id. at 866. We reached this conclusion by recognizing that a transfer solely for the purpose of defeating the spouse's statutory share is void. However, we found that wife and husband, a subsequent childless spouse, had maintained separate properties and that wife had gone to the bank to establish a trust for the purpose of obtaining aid in handling her affairs three years prior to her death. Id. at 862. The trust agreement reserved to the wife the right to income from the trust for life, the right to control the actions of the trustee, and the right to revoke. [Id.](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1976131159&pubNum=0000441&originatingDoc=If1047d306e2511eaafc9a4147037e074&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) Husband was granted the right to reside in the settlor's former house for six months following her death. [Id.](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1976131159&pubNum=0000441&originatingDoc=If1047d306e2511eaafc9a4147037e074&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) As time went on, wife was confined to a nursing home and her separate funds were used to pay for her care. [Id.](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1976131159&pubNum=0000441&originatingDoc=If1047d306e2511eaafc9a4147037e074&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) The Leazenby court observed that it was obvious husband was aware of this situation and had acceded to it. Id. at 866. There was no indication that it was the settlor's intent to use the device of a trust to defeat her husband's statutory share in her estate; rather, she had merely conveyed a portion of her estate during her lifetime, which she had every right to do. See id. at 866-67.

Approximately ten years later, in Walker v. Lawson, 526 N.E.2d 968, 969 (Ind. 1988), our supreme court was faced with the question of whether it was malpractice for an attorney to draft a will, and not a trust, for a client who had recently learned of a fatal diagnosis and who “had come [to the attorney] for the stated purpose of depriving her husband of any interest in her estate.” Acknowledging both the rule set forth in [Leazenby](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1976131159&pubNum=0000578&originatingDoc=If1047d306e2511eaafc9a4147037e074&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) and the holding of Crawfordsville Trust Co. v. Ramsey, 55 Ind.App. 40, 100 N.E.1049 (1913), in which the court upheld the trial court's invalidation of assignments of stock and bonds by a spouse who made the assignments knowing he would soon die and for the sole purpose of defeating his spouse's elective rights with respect to the assigned property, the Walker court ruled that neither the conveyance of her land to a trust naming her children as beneficiaries nor a conveyance of that land to herself and her children with survivorship rights would have been effective against the surviving spouse's elective rights. [Id.](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1988101893&pubNum=0000578&originatingDoc=If1047d306e2511eaafc9a4147037e074&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation))

Again after a ten-year interval, this court decided Dunnewind, 697 N.E.2d at 487, where we found in favor of the surviving spouse's right of election. Here, the settlor executed a will in 1976 in which she left all her assets to her children from a prior marriage. Id. at 487. After discovering she was terminally ill in 1995, she created a trust under which her husband would receive a life estate in the marital residence and household goods, as well as a predetermined sum of money, with the remainder to go to settlor's children. [Id.](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1998143075&pubNum=0000578&originatingDoc=If1047d306e2511eaafc9a4147037e074&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) The trust made no provision for payment of income to the settlor. Based on the evidence presented, the Dunnewind court opined that “there was no showing that the trust was executed to assist the [settlor] with business or financial affairs,” and held that “the evidence presented at the hearing supports the trial court's findings that [the settlor] executed the trust in contemplation of her impending death and did so to defeat [husband's] statutory share ... Given such circumstances, the trust fails to defeat the spouse's share given the law announced in Crawfordsville and Walker.” Id. at 487, 490. We also noted that the trust had a “testamentary character,” because the trust agreement did not give the settlor a life interest in the trust property, yet the trustee, the settlor's daughter, permitted her to reside in the residential property and paid to her the trust's income until the settlor's death. [Id.](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1998143075&pubNum=0000578&originatingDoc=If1047d306e2511eaafc9a4147037e074&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) The court found that neither the settlor nor the beneficiaries intended the transfer to the trust to take effect until the settlor's death, similar to the finding in [Crawfordsville](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1913025605&originatingDoc=If1047d306e2511eaafc9a4147037e074&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)). Id. at 490.

Finally, in In re Estate of Weitzman, 724 N.E.2d 1120, 1121 (Ind. Ct. App. 2000), both husband and wife had children from a prior marriage. Before the marriage, Wife refused to sign a prenuptial agreement that would have waived her elective share rights to her husband's estate. [Id.](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=2000063823&pubNum=0000578&originatingDoc=If1047d306e2511eaafc9a4147037e074&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) Four years into the marriage, husband executed a revocable living trust, benefiting his children and appointing the bank as trustee while husband retained the power to direct all trust investment and receive the income from the trust. [Id.](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=2000063823&pubNum=0000578&originatingDoc=If1047d306e2511eaafc9a4147037e074&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) Within three years, husband transferred significant assets into the trust. [Id.](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=2000063823&pubNum=0000578&originatingDoc=If1047d306e2511eaafc9a4147037e074&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) Wife knew that husband had a trust; however, there was no evidence she was aware of the provisions of the trust. Id. at 1121-22. Husband died six years after creating the trust and several years after funding it. [Id.](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=2000063823&pubNum=0000578&originatingDoc=If1047d306e2511eaafc9a4147037e074&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) After describing the nature and effect of an inter vivos trust and restating the general rule in Leazenby and the policy grounds upon which that decision was reached, the Weitzman court stated, “[t]here is one pertinent exception to the rules and policies we relied on in Leazenby. When a testator executes a trust in contemplation of his impending death and does so in order to defeat the surviving spouse's statutory share, the trust will be considered testamentary in nature and will not defeat the spouse's share.” Id. at 1123. Finding that the facts did not negate the possibility that husband's intent was to defeat the surviving spouse's elective share, we reversed the trial court's summary judgment in favor of husband and remanded for trial. Id. at 1125.

The court affirmed stating:

Accordingly, unlike Weitzman, where the wife knew that husband had a trust but was unfamiliar with its provisions, here, there is overwhelming evidence from which the trial court could have reasonably inferred that Anil and Dipa were aware of the other spouse's trust provisions and estate planning. See In re Weitzman, 724 N.E.2d at 1121. In fact, Anil and Dipa commenced their trust creation with the same attorney and although they later retained individual counsel, they were advised by the same financial planner, and had joint meetings in which their respective assets were discussed. Anil transferred his assets to the Trust with Dipa's full knowledge while at the same time she transferred her own assets to a nearly identical trust. As there is “no conclusive evidence that there was a secreting of the real ownership of the property, or that [Dipa] did not know and fully approve of the trust agreement,” we conclude that Anil did not create the Trust with the intent to disinherit Dipa. See Leazenby, 355 N.E.2d at 866. Consequently, as there is substantial evidence that Anil did not create the Trust in contemplation of death and with the intent to disinherit Dipa, we affirm the trial court's decision to deny Dipa's claim to satisfy her spousal elective share from the Trust corpus.

## **Duty to Consider Other Assets When Making Distribution**

. Technically, Matter of William J. Raggio Family Trust, 460 P.3d 969 (Nv. 2020), was a discovery action but the substantive issue is fascinating. Widow was trustee and beneficiary of a marital trust and a bypass trust, which had different beneficiaries. She made distribution to herself from the marital trust that ultimately passed to her husband’s family, as opposed to the bypass trust that passed to hers. The court approved that action. The opinion states:

The narrow question before us is whether Dale, as trustee, has an obligation to consider other assets, including those in the Credit Shelter Trust, before making distributions to herself, as beneficiary, from the Marital Trust. We conclude she does not. NRS 163.4175 states, “[e]xcept as otherwise provided in the trust instrument, the trustee is not required to consider a beneficiary’s assets or resources in determining whether to make a distribution of trust assets.” Thus, Nevada trust law does not obligate a trustee to consider other assets or resources before making a distribution unless the trust instrument itself sets forth such a requirement. Accordingly, to determine whether Dale has such an obligation, we must look to the language of the trust instrument.

Section 5.1 of the Marital Trust states, in relevant part, that the trustee “shall pay to or apply for the benefit of [Dale] as much of the principal of the Trust as the Trustee, in the Trustee’s discretion, shall deem necessary for the proper support, care, and maintenance” of Dale. Both Dale and Righetti [remainderman of the marital trust] argue that the term “necessary” is the focal point for our inquiry, and they offer two conflicting interpretations of it. Dale interprets “necessary” as referring only to the amount of disbursement needed for her “proper support, care, and maintenance,” without regard to her other assets. Righetti, on the other hand, interprets “necessary” as creating a threshold of financial need. Under this interpretation, Dale, as trustee, cannot distribute trust funds unless she can first show that without the trust distributions, she could not provide for her own “support, care, and maintenance.” Righetti argues that the relevant discovery inquiry in determining whether a distribution is “necessary” to Dale is to determine what other financial means she has for her support, care, and maintenance.

The district court appears to have adopted Righetti’s interpretation of “necessary,” in that it creates a threshold of financial need. The district court determined that it “cannot determine what is necessary and proper without a complete understanding of the trustee’s circumstances, to include standard of living and supportive resources beyond the marital deduction trust.” We conclude that this determination was clearly erroneous for several reasons.

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We thus conclude that the district court’s interpretation is contrary to NRS 163.4175, which requires trustees to consider other assets only if the trust instrument itself invokes the exception. The district court should ***\*975*** have begun its analysis from the position that Dale was not obligated to consider her other assets or resources before making a distribution unless the exception was invoked. Instead, the district court disregarded NRS 163.4175 and began evaluating whether one of William Raggio’s “implicit intents was to preserve some trust corpus ... for the benefit of his two daughters and not exhaust the bypass trust in favor of preserving the credit shelter trust.” NRS 163.4175 clearly provides that, if a settlor wants trustees to consider a beneficiary’s other assets, the settlor must so state in the trust instrument. We cannot infer an exception to NRS 163.4175 based solely on the terms “necessary” and “proper” in the trust instrument, as those terms appear frequently in trusts but their meanings depend on the circumstances and text of the instruments. See, e.g., Del Tr. Co., 95 A.2d at 47 (holding that “upon a full reading of the will in the light of the surrounding circumstances ... [the term “necessary” was] not language of condition[,] but [rather, was] language fixing the standard by which the trustee is to exercise its discretion in determining the amount to be spent”). Rather, it must be clear from the trust as a whole that the settlor’s intent is to require the trustee to consider other assets. William Raggio did not express that intent.

Therefore, we conclude the district court erred as a matter of law in compelling discovery of the accounting and distributions of the Credit Shelter Trust. Neither NRS 163.4175 nor the Raggio Trust requires Dale to consider her other assets in making distributions from the Marital Trust, and thus, information about those assets is irrelevant.

## **Georgia Allows Beneficiaries To Amend Trust To Give Themselves The Power To Remove And Replace Trustees**

. In Trust Under Agreement of Taylor, 164 A.3d 1147 (Pa. 2017), the Pennsylvania Supreme Court held that an otherwise valid amendment to a trust under the uniform act would not be valid if the purpose of the amendment was to allow beneficiaries to remove and replace the trustee. The court reasoned that the uniform act had specific provisions dealing with trustee removal.

Georgia has not adopted the Uniform Trust Code but has several provisions that are similar. The Beneficiaries of a trust may modify the trust if they all agree, the trustee receives notice, and a court finds no violation of a material purpose, and, if the settlor is dead. OCGA § 53-12-61(c)(1). There is also a trustee removal provision, OCGA § 53-12-221(a), that allows removal per the terms of the trust instrument, or upon petition to a court showing “good cause.”

In Glass v. Faircloth, 840 S.E.2d 724 (Ga. App. 2020), the beneficiaries wanted to change trustees in a fee dispute. Interestingly, the court noted that because the beneficiaries could amend the trust under Georgia law, it did not have to grapple with whether the fees were in fact excessive. The court held that the two cited provisions were easily reconcilable:

First, the Modification Statute operates, as here, only after the settlor’s death (whereas the Removal Statute contains no such restriction), when concerns could arise that the settlor did not anticipate and can do nothing to resolve. Second, the Removal Statute, which operates at any time, allows initiation by “any interested person” and does not require consent of any of the beneficiaries. Thus, these two provisions address different scenarios and are not inherently inconsistent, and there is no ambiguity or practical effect that frustrates the purpose of either provision.

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Further, “[a]ll statutes are presumed to be enacted by the legislature with full knowledge of the existing condition of the law and with reference to it... [W]hen a statute is amended, from the addition of words it may be presumed that the legislature intended some change in the existing law.” In light of this, when the legislature amended the Modification Statute in 2018 to allow trust modification after the death of the settlor (under the conditions enumerated in the statute), the legislature could have limited that authority with respect to removal of trustees. It did not. The Modification Statute instead contains broad authority to modify trusts after the death of the settlor so long as the court determines that the notice provisions are met, all beneficiaries consent, and the purpose of the trust is preserved. This is not an absurd or impracticable result, and it is not inconsistent with the ability to remove a trustee (without the consent of the beneficiaries) at any time due to misconduct or for other good cause. The Modification Statute, unlike the Removal Statute, does not contain a burden to show good cause and encompasses scenarios that do not involve trustee misconduct. In light of the plain statutory language requiring the court to approve a modification under the terms in the Modification Statute, we will not read into the Code a limitation that is absent.

Footnote 17 states:

The 2018 amendment to the Modification Statute was part of a raft of Trust Code changes adopted in the same bill. See Ga. L. 2018, p. 262. Notably, the Removal Statute does not say a “trustee may only be removed” for good cause. Compare with [OCGA § 53-12-501 (b) (2)](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000468&cite=GAST53-12-501&originatingDoc=Iee496310632811eaae65c24a92a27fc2&refType=SP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_a83b000018c76) (“This article shall not apply to ... [a] power to appoint or remove a trustee or trust director.”). To the contrary, the legislature did not change the language in [OCGA § 53-12-221](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000468&cite=GAST53-12-221&originatingDoc=Iee496310632811eaae65c24a92a27fc2&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) that affords the authority to remove a trustee in accordance with the terms of the trust, even as it granted authority to modify trust terms under [OCGA § 53-12-61](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000468&cite=GAST53-12-61&originatingDoc=Iee496310632811eaae65c24a92a27fc2&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)).

## **Gift Causa Mortis**

. Sad circumstances produced a fascinating case in In re Estate of Oaks, 944 N.W.2d 6112 (Wis. Ct. App. 2020). The facts were simple:

Stouff and Oaks were in a romantic relationship for over twenty-three years—from February 1995 until Oaks’ death on March 8, 2018. They never married, but they lived together for approximately ten years—from 2008 until Oaks’ death. Oaks had been divorced twice and had an adult daughter, Cheri Wardell, who was not Stouff’s offspring. It is undisputed that Oaks and Wardell did not have a “close relationship” and were “estranged for many years” prior to Oaks’ death.

In the early morning hours of March 8, 2018, Oaks fatally shot himself in the head in the home he shared with Stouff, while Stouff was asleep upstairs. Stouff woke when she heard a loud bang, and when she went downstairs to investigate, she found two handwritten notes on a table. The first note read:

3-7-18

Lynne Stouff has been my companion and my crutch for a long while.

As I leave this existence I want all worldly belongings to be assigned to Lynne.

David Oaks

The second note read:

Lynne—

This is all I can go with this—Thank you for being there for me all these years.

I love you.

It is undisputed that Oaks died intestate—that is, without a valid will. *See Intestate,* BLACK'S LAW DICTIONARY (11th ed. 2019). It is further undisputed that Oaks died unmarried and that Wardell was his only child. As such, Oaks’ entire estate would normally pass to Wardell under the general rules of intestate succession, as set forth in WIS. STAT. § 852.01 (2017-18).

The question before the court was whether a suicide can give rise to gift causa mortis. The court held it could, reviewing authority going both ways from other jurisdictions:

The Estate argues that Stouff cannot meet the second and third requirements for a gift causa mortis. It concedes Stouff can prove that Oaks gifted property to her in anticipation of his death. However, the Estate argues Stouff cannot prove Oaks gifted that property in anticipation of his death from a present illness or external peril because suicide is not a present illness or external peril. Further, because Oaks died as a result of suicide, the Estate argues he did not die from a present illness or external peril. For these reasons, the Estate contends a gift causa mortis can never occur in the context of a donor’s suicide.

While the Estate concedes that no Wisconsin case to date has addressed this issue, it asserts that “[h]istorically, the common law has maintained that a gift causa mortis made in contemplation of the donor’s suicide is void.” The Estate further contends that various other jurisdictions have followed this historical rule and have held that “death by suicide does not satisfy the requirement that a gift be made in expectation of imminent death from illness or impending peril.”

We do not find the Estate’s argument in this regard persuasive. In making its argument, the Estate fails to distinguish between the manner of a donor’s death and the ultimate cause of the donor’s death. While the manner of death may be suicide, that suicide may, in some cases, have been caused by a present mental illness—for instance, depression. Accordingly, even in a case in which the donor died by suicide, a party may be able to show that the donor made a gift in expectation of his or her death from a present mental illness, and that the present mental illness caused the donor’s death. Thus, contrary to the Estate’s contention, the fact that a donor died by suicide does not automatically prevent a party from establishing that the donor made a gift causa mortis.

In support of its argument to the contrary, the Estate relies primarily on two cases from other jurisdictions—*Ray v. Leader Federal Savings & Loan Ass'n*, 40 Tenn.App. 625, 292 S.W.2d 458 (1953), and *Pikeville National Bank & Trust Co. v. Shirley*, 281 Ky. 150, 135 S.W.2d 426 (Ky. Ct. App. 1939). However, neither of those cases supports the Estate’s argument that a gift causa mortis can never occur in the context of a donor’s suicide.

In *Ray*, the Tennessee Court of Appeals was confronted with the following question when analyzing an alleged gift causa mortis: “Does death by contemplated suicide by a person who is presumed to be physically and mentally well, as in the instant case, arise from an apprehension due to a peculiar sickness, peril or danger?” Ray, 292 S.W.2d at 467. In answering that question, the court observed there was “nothing in the record to indicate that [the deceased] was not fully possessed of his mental faculties” at the time of his suicide. Id. On those facts, the court concluded that “[s]ickness, peril and danger, as used in definitions of [gifts] causa mortis ... mean something other than a determination of an individual who is presumed to be well, physically and mentally, to take his life.” Id.

As the above excerpts make clear, Ray addressed whether a gift causa mortis could occur in circumstances where the donor was “presumed to be physically and mentally well” at the time of his suicide. Id. Ray did not address whether a gift causa mortis can occur when the donor’s suicide was caused by a present mental illness. Accordingly, Ray does not compel a conclusion that a gift causa mortis can never occur when the donor died by suicide.

The Estate’s reliance on Pikeville National Bank is similarly misplaced. In that case, the Kentucky Court of Appeals concluded certain gifts made before the donor’s suicide did not qualify as gifts causa mortis “because vital and necessary elements [were] lacking, one of which is that such gifts must be made in expectation of imminent death from a disease or peril then impending.” Pikeville Nat'l Bank, 135 S.W.2d at 429. The court reasoned:

While it is alleged in the petition and admitted by answer that decedent was afflicted with tuberculosis, he did not die of that disease, but came to his death by self-destruction which the record indicates he had contemplated and determined upon several days before he carried his determined purpose into effect. Normal men are the arbiters of their own fate so far as suicide is concerned, since that is a matter within their own power of control.

Id.

The court in Pikeville National Bank considered a donor who had contemplated suicide for several days before making a decision to act. In addition, the court presumed that the donor was a “normal” man whose decision to end his life was a rational choice within his own power and control. As in [Ray](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1956128192&pubNum=0000713&originatingDoc=I644843b0a48311ea8406df7959f232f7&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)), the court did not consider a situation in which the donor died by suicide as a result of a present mental illness. For that reason, neither Ray nor Pikeville National Bank convinces us that a gift causa mortis can never occur in the context of a donor’s suicide.[4](https://1.next.westlaw.com/Document/I644843b0a48311ea8406df7959f232f7/View/FullText.html?transitionType=UniqueDocItem&contextData=(sc.Default)&userEnteredCitation=2020+wl+2832986#co_footnote_B00052051160399)

We find more persuasive two cases from other jurisdictions, in which the courts concluded a gift causa mortis had occurred where the donor’s suicide was the result of a present mental illness. In the first of those cases, the evidence showed that the donor was in “a serious state of mental depression” following his divorce. In re Van Wormer's Estate, 255 Mich. 399, 238 N.W. 210, 210-11 (1931). He told his mother that he was going to California to “go just as far away as he could from his troubles.” Id. at 211. Before leaving, the donor purchased stock and directed that it be issued in his brother’s name. [Id.](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1931107520&pubNum=0000542&originatingDoc=I644843b0a48311ea8406df7959f232f7&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) He then traveled to California, and while there he died by suicide. [Id.](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1931107520&pubNum=0000542&originatingDoc=I644843b0a48311ea8406df7959f232f7&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation))

The Michigan Supreme Court concluded the donor’s purchase of stock in his brother’s name was a gift causa mortis. The court stated a gift causa mortis “cannot be sustained unless it appears from the record that at the time of the transaction the donor believed he was suffering from an affliction from which he might not recover and from which in fact he did not.” Id. The court then concluded that requirement was satisfied in the case before it, explaining:

The melancholia which evidently resulted in suicide had fastened itself upon [the] deceased before the date of the gift, and he obviously was convinced at that time that he could not continue on indefinitely in his depressed mental state. He attempted to travel away from his troubles. Weeks later he wrote, as quoted above, that he was then gradually getting a desire to want to live, and added in the same letter that he was then experiencing his first encouragement, and that he would probably return the middle of the summer, ‘provided I meet with any measure of improvement.’ The end a month later indicates he fought a losing fight. His gift made in contemplation should not be set aside.

Id. at 212.

The New Jersey Supreme Court reached a similar conclusion in Scherer v. Hyland, 75 N.J. 127, 380 A.2d 698 (1977). There, the donor was “acutely depressed” during the weeks leading up to her death by suicide. Id. at 699. Before her death, she left a note stating that she bequeathed all of her possessions to her romantic partner. Id. at 699-700. Under those circumstances, the court concluded the donor had made a gift causa mortis. The court expressly rejected the appellant’s contention that suicide is “not the sort of peril that will sustain a gift causa mortis.” Id. at 702. The court explained:

While it is true that a gift causa mortis is made by the donor with a view to impending death, death is no less impending because of a resolve to commit suicide. Nor does that fixed purpose constitute any lesser or less imminent peril than does a ravaging disease. Indeed, given the despair sufficient to end it all, the peril attendant upon contemplated suicide may reasonably be viewed as even more imminent than that accompanying many illnesses which prove ultimately to be fatal. And, the notion that one in a state of mental depression serious enough to lead to suicide is somehow “freer” to renounce the depression and thus the danger than one suffering from a physical illness, although it has a certain augustinian appeal, has long since been replaced by more enlightened views of human psychology.

Id. (citations omitted).

Like the Michigan and New Jersey Supreme Courts, we conclude a gift causa mortis can occur in a case where the donor died by suicide as a result of a present mental illness. We therefore reject the Estate’s assertion that a gift causa mortis can never be enforced in a case where the donor died by suicide.

The court concluded the decedent was a Vietnam veteran with PTSD who was depressed. The court also agreed that delivery occurred through the note:

Just before ending his life, Oaks left a note on a table in the home he shared with Stouff directing that all of his “worldly belongings” should go to Stouff upon his death. Stouff was already in physical possession of the residence and all of the property inside it, and she had access to indicia of ownership for the rest of Oaks’ belongings—i.e., keys to his vehicles, checkbooks, and bank account information. After leaving the note, Oaks fatally shot himself in the head while Stouff was asleep in the upper floor of their residence. Having been awoken by the gunshot, Stouff went downstairs and found the note on the table. We agree with Stouff that under these circumstances, “when Mr. Oaks left the note for Ms. Stouff on the table and when Ms. Stouff found the note, he completed delivery for the purpose of the gift causa mortis analysis.” (Emphasis omitted.)

Our supreme court’s decision in Sorenson further supports this conclusion. In that case, the court affirmed a circuit court’s finding that Edith Detjen had made a completed gift to Ann Friedmann of money in a bank account through the “symbolical delivery” to Friedmann of the account passbook. Sorenson, 34 Wis. 2d at 55-56, 148 N.W.2d 745. The evidence in [Sorenson](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1967121826&pubNum=0000595&originatingDoc=I644843b0a48311ea8406df7959f232f7&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) showed that Detjen, who had been hemorrhaging from the mouth, was waiting at home for an ambulance to take her to the hospital. Id. at 51, 148 N.W.2d 745. Two of her friends testified that while waiting for the ambulance, Detjen called Friedmann into the room and told Friedmann that “she was making a gift [to her] of the West Side Bank account and that she, Ann Friedmann, should withdraw the money.” Id.

The friends’ testimony differed, however, regarding Detjen’s delivery of the account passbook to Friedmann. One friend testified Detjen gave the passbook to Friedmann immediately after informing Friedmann of the gift. Id. The other friend testified that Detjen stated the passbook was in a box inside a dresser drawer, but the same friend later testified that she saw a book of the same color as Detjen’s passbook in Friedmann’s hands. Id. at 51-52, 148 N.W.2d 745. Friedmann testified Detjen had given her the passbook when the account was opened and it had been in Friedmann’s possession ever since. Id. at 52, 148 N.W.2d 745. Our supreme court concluded these differences in the witnesses’ testimony were “immaterial,” explaining that “[p]roperty validly in the possession of the donee need not be returned to the donor so that it can be handed back to the donee.” Id. at 55-56, 148 N.W.2d 745. In other words, the fact that Friedmann was—according to her own testimony—already in possession of the account passbook did not prevent Detjen from completing a valid delivery of the gift.

Similarly, in this case, the fact that Stouff was already in possession of Oaks’ property by virtue of their cohabitation did not prevent Oaks from making a valid delivery of his property to Stouff for purposes of the fourth requirement for a gift causa mortis. Instead, under the “relaxed rule” that applies when assessing the delivery of a gift between members of the same household, see Potts, 127 Wis. 2d at 54, 377 N.W.2d 204, we conclude Oaks delivered his property to Stouff by leaving a note informing her of the gift on a table in their shared residence, which he could be reasonably certain Stouff would find when she came downstairs.

## **Parol Evidence Allowed In Virginia To Interpret Ambiguity**

. The clause at issue in Larsen v. Stack, 842 S.E. 2d 372 (Va. 2020) read as follows:

FIFTH: I devise the following described property to my children, namely, Pamela Larsen Stack and Kirk Larsen, subject to my wife, Sandra Flora Larsen, having the right to reside in our home located at 394 Mystic Lane, Wirtz, Virginia, 24184, for so long as she is physically and mentally able to do so, and for my wife, Sandra Flora Larsen to receive the monthly rental payments, as provided for in the PCS Site Agreement (Cell Tower), dated April 16, 2013, for as long as she resides in our home, it being all that certain tract or parcel of land (Tax Parcel #28-90) containing 101.39 acres, more or less, situated, lying, and being in the Gills Creek Magisterial District, Franklin County, Virginia, it being the same property conveyed to Erik Larsen, from James C. Ellis, by Deed dated February 7, 1972, said deed being of record in the Clerk’s Office of the Circuit Court of Franklin County, Virginia, in Deed Book 277, at page 38.

A question was whether wife had a life estate in the property. The trial court allowed the decedent’s lawyer to testify:

The circuit court held a hearing regarding the declaratory judgment action on January 3, 2019. During the hearing, the circuit court determined that Erik’s will did not clearly establish the scope of Sandra’s interest in the house and farm. Consequently, the circuit court permitted W. Colby Brown, the attorney who drafted Erik’s will, to testify.

Brown testified that Erik intended for Sandra “to be able to stay on the property, and ... [receive] the money from the cell phone tower.” However, Brown clarified that Erik “wanted his children to end up with the property.” Brown explained that Erik did not give Sandra a life estate in the property because he was concerned that she would be required to sell such an interest before she could obtain Medicaid coverage.

Brown believed that Erik intended for Sandra to have access to the entire farm as long she was physically and mentally able to reside in the house. Brown explained that “in the event that [Sandra] had to go into a nursing home basically, or ... couldn't live by herself anymore, something like that, then at that point her interest in the property would dissolve ... and then it would go to the children.”

At the conclusion of the hearing, the circuit court determined that Sandra did not have a life estate in the property. The circuit court explained that Erik’s will gave Sandra the right to reside in Erik’s house and the right to access the entire farm. The circuit court then noted that Sandra’s rights were “subject to be terminated when she is no longer physically or mentally able to reside in the home.”

With respect to the lawyer’s testimony, the opinion states:

Sandra contends that the circuit court erred by considering parol evidence when it construed the limitation that Erik’s will placed on her right to reside on the property. Specifically, Sandra argues that the circuit court erred by considering Brown’s testimony to determine that Sandra’s interest in the property would end “in the event she had to go into a nursing home ... or couldn't live by herself anymore.” Again, we disagree with Sandra’s argument.

As previously stated, parol evidence may be considered when the language of a will is ambiguous. See Gaymon, 258 Va. at 230, 519 S.E.2d 142. In such cases, “[p]arol evidence is admissible to enable the court to identify the property intended to be given by will, or to assist it in determining the quantum of interest which is to pass by the will.” Parsons v. Fitchett, 148 Va. 322, 329, 138 S.E. 491 (1927) (quotation omitted).

Erik’s will was ambiguous in several ways. The will did not clearly define the scope of Sandra’s right to reside on the property. Notably, the will failed to indicate whether Sandra had the right to access and enjoy the entire property, or whether she only had the right to live in Erik’s house.

The will was also ambiguous regarding the limitation that it placed on Sandra’s rights. Pursuant to Erik’s will, Sandra could reside on the property “for so long as she [was] physically and mentally able to do so.” The will did not provide any further guidance concerning this limitation.

Brown’s testimony addressed the ambiguous provisions of Erik’s will. Brown explained that Erik intended to give Sandra the right to reside on the entire property for as long she was physically and mentally able to live there. Brown then testified that Erik intended for Sandra’s interest in the property to end “in the event that she had to go into a nursing home” or she “couldn't live by herself anymore.”

We conclude that Brown’s testimony was necessary to resolve the ambiguities in the will. Brown’s testimony explained Erik’s intent regarding the scope of Sandra’s rights and the limitation that Erik placed on those rights.

Although Sandra contends that Brown’s testimony impermissibly modified the terms of Erik’s will, we find that Brown’s testimony and the terms of the will were essentially consistent. We note that Erik’s will only gave Sandra the right to reside on the property.

Under these circumstances, we conclude that the circuit court did not err by considering Brown’s testimony to determine the scope of Sandra’s right to reside on the property and the limitation that the will placed on that right.

## **Separation Agreement Anticipating Divorce Waives Intestate Rights**

. In the Matter of Estate of Petelle, 462 P.3d 848 (Wa. 2020), the parties entered into a separation agreement but husband died before the divorce was adjudicated. The question was whether the agreement waived wife’s intestate rights. The majority held it did:

In the contract, the parties agreed “to make a *complete and final settlement of all their marital and property rights* and obligations on the following terms and conditions.” Clerk's Papers (CP) at 43 (emphasis added). The contract also provides that the “contract shall be final and binding upon the execution of both parties, whether or not a legal separation or decree of dissolution is obtained[,]” and, by its terms, the contract remained valid and enforceable against the **estate** of either party if either party died after the execution of the contract. CP at 43-44, 48. Though the contract contains a “Full Satisfaction of All Claims” section, the right to intestate succession is not mentioned. CP at 46.

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The Court of Appeals reasoned that “[t]his language is, arguably, sufficient to constitute waiver of all marital and property rights flowing from the marital relationship, including the right to intestate succession.” *Petelle*, 8 Wash. App. 2d at 721. We agree. This provision is an express declaration to resolve “all marital and property rights,” leaving no ambiguity that some or any marital or property rights remain unresolved. Our conclusion is further supported by a general purpose of separation contracts—to divide assets and liabilities in preparation for divorce.

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The fact that the right to intestate succession was not specifically mentioned in the contract does not limit the clear and explicit language providing the agreement is a complete and final settlement of all marital and property rights. The rights of a surviving spouse under RCW 11.04.015 flow from the marital status. Because the right to intestate succession is a result of the marital status, the right to intestate succession is similar to a marital or property right and we find the right is encompassed in this language.

Three of the nine justices dissented, in an interesting opinion which notes:

In my view, the parties made their intent known. Michael and Michelle sought to accomplish the general purpose of separation contracts—dividing assets and liabilities in order to resolve the immediacy of their separation and possible divorce. They did not intend for the agreement to extend beyond those events. They understood that their divorce may not occur, in which case had a will been made, it would have had to state that Michelle was Michael's wife and that he specifically intended not to include her in the will. In re *Estate* of Lindsay, 91 Wash. App. 944, 949, 957 P.2d 818 (1998) (“A testator has the right to intentionally disinherit a surviving spouse.”); Strait v. Kennedy, 103 Wash. App. 626, 634, 13 P.3d 671 (2000) (“[A] simple will or codicil to an earlier will stating that the testator intends to leave nothing to the spouse is sufficient [to disinherit a spouse].”). Specific language disinheriting a spouse is required in a will, and I see no reason why it should not be required in a separation contract. “ ‘[W]here a person has the right to die intestate ... he is charged with full knowledge of who will succeed to his property if he dies intestate [and] the assumption exists that ... he is satisfied with the will the law of the state made for him.’ ” Pitzer v. Union Bank of Cal., 141 Wash.2d 539, 550, 9 P.3d 805 (2000)(alterations in original) (quoting Wilson v. Jones, 281 S.C. 230, 233, 314 S.E.2d 341 (1984)) (discussing Hesthagen v. Harby, 78 Wash.2d 934, 481 P.2d 438 (1971)). Because Michael died intestate while married to Michelle, she was his surviving spouse and entitled to take under RCW 11.04.015(1)(c).

I further disagree with the majority that the contractual language is broad enough to demonstrate Michelle knew she was waiving intestate inheritance rights. See majority at 851. The majority states that the rights of a surviving spouse flow from marital status, and so they are encompassed in the separation contract's statement resolving all marital rights. Id. But “[w]aiver is the intentional relinquishment of a known right.” Wagner v. Wagner, 95 Wash.2d 94, 102, 621 P.2d 1279 (1980) (emphasis added). As noted above, there is no indication in the terms and conditions of the separation agreement indicating it extended to testamentary decisions, and I can find no authority from this court or from the legislature characterizing intestate inheritance rights as marital or property rights.

Moreover, the rights of a surviving spouse include more than just dividing assets for dissolution of marriage. They include rights under the wrongful death statute, ch. 4.20 RCW; rights to Social Security survivor benefits; rights under the Employee Retirement Income Security Act, 29 U.S.C. 18; and the right to control the disposition of remains under RCW 68.50.160. Amicus Curiae Mem. in Supp. of Review at 6. Parties in separation and divorce proceedings are often unrepresented or have minimal access to legal assistance. Id. at 4-5. We should not assume, as the majority does, that pro se litigants in the past have comprehended the full legal consequence of agreeing to resolve all marital rights, especially considering the complexity of those rights. This result is even more concerning because the statute governing separation contracts, RCW 26.09.070(1), does not mention settling questions of inheritance. Just as we should not assume pro se litigants will recognize that intestate inheritance rights are encompassed in the terms marital and property rights when no prior authority has endorsed this holding, we should not assume these litigants intended to do something the statute does not mention.

## **Attorney Insurance Policy Does Not Cover Attorney Acting as Trustee**

. Philip Farthing, an attorney, was liable to the Higgerson beneficiaries of various family trusts of which he was trustee on account of his negligent investment of trust assets. Did his professional liability policy cover him? That was at issue in ALPS Property & Casualty Insurance Company v. Higgerson, 805 Fed.Appx. 193 (E.D. Va. 2020)(unpublished). The policy covered acting as a trustee but excluded negligent supervision of funds. The opinion states:

Applying those standards, the court concluded that the policy exclusion for the “negligent supervision” of funds or property clearly and unambiguously applied, foreclosing coverage.[3](https://1.next.westlaw.com/Document/I15e7e680711611eab9598d2db129301e/View/FullText.html?transitionType=UniqueDocItem&contextData=(sc.DocLink)&userEnteredCitation=805+Fed.appx.+193#co_footnote_B00032050655099) Id. at \*6. Under that ***\*196*** exclusion, the policy does not apply to any claim arising from or in connection with:

Any conversion, misappropriation, improper commingling or negligent supervision by any person of client or trust account funds or property, or funds or property of any other person held or controlled by an **Insured** in any capacity or under any authority, including any loss or reduction in value of such funds or property.

J.A. 61–62. By its “clear and express terms,” the district court found, that provision “facially applies” to stocks “held or controlled” by Farthing in “any capacity,” including his capacity as trustee of the Higgerson family trusts. ALPS, 2018 WL 4927366, at \*6.

The district court acknowledged, as the Higgerson Defendants argued, that the phrase “negligent supervision” typically connotes “the supervision of other people,” not funds or property. Id. at \*7 n.10. But here, the court held, the context provided by the full provision – with its express reference to the “negligent supervision ... of client or trust account funds or property, or funds or property of any other person,” J.A. 62 – “leaves no doubt that it excludes claims arising from the negligent supervision of funds or property held or controlled by the insured.” ALPS, 2018 WL 4927366, at \*7 n.10. Moreover, the district court reasoned, case law shows that “supervision” is commonly used to describe the management not only of people but also of investments, including stock portfolios. Id. at \*7 (quoting, e.g., Migdal v. Rowe Price-Fleming Int’l, Inc., 248 F.3d 321, 324 (4th Cir. 2001) (noting that “[m]ost funds are externally managed – each fund contracts with an investment adviser to recommend and supervise the fund’s investments”) (emphasis added)). And all of that, the district court concluded, is consistent with the definition of “supervision” in Black’s Law Dictionary – “[t]he series of acts involved in managing, directing, or overseeing persons or projects,” Supervision, Black’s Law Dictionary (10th ed. 2014) – on which Virginia courts have relied for the proposition that “supervision” may refer to the management or oversight of things (such as property) as well as people. See ALPS, 2018 WL 4927366, at \*8 (citing Hutton v. Commonwealth, 66 Va.App. 714, 791 S.E.2d 750, 753 (2016)).

It was equally clear, the district court held, that Farthing’s conduct qualified as “negligent” within the meaning of the exclusion. There was no need to consider in this case the “precise contours of the ordinary meaning of the word ‘negligence,’ ” the district court explained, because Farthing’s investment activities were “expressly determined to be ‘reckless’ breaches of his fiduciary duties during the underlying state court lawsuit.” Id. at \*7. An insurer’s duty to indemnify is governed by the plain terms of the policy and the “litigated facts” in the underlying state action, [id.](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=2045704604&pubNum=0000711&originatingDoc=I15e7e680711611eab9598d2db129301e&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) (quoting CACI Int’1, Inc. v. St. Paul Fire & Marine Ins. Co., 566 F.3d 150, 155 (4th Cir. 2009)), and here, the prior finding of recklessness “establishes, as a matter of law, a lack of care that rises to, and exceeds, ordinary negligence,” [id.](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=2045704604&pubNum=0000506&originatingDoc=I15e7e680711611eab9598d2db129301e&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation))

## **Trusts Reformed to Avoid Reciprocity**

. In Matter of Jill Petrie St. Clair Trust Reformation**,** 464 P.3d 326 (Kan. 2020), spouses created trusts that were not intended to be reciprocal but the drafter omitted the relevant different provisions as the opinion notes:

In September 2003, Jill executed a trust agreement establishing the Jill Petrie St. Clair Trust. She named William J. Wallisch the trustee. The trust made her husband, William Paxson St. Clair, a life beneficiary of the trust's income. Upon William's death, the trust's income would then be distributed to Jill and William's children and grandchildren living at the time the trust was created, and the principal would eventually be distributed to the grandchildren or their estates.

In December 2002, before Jill created her trust, William established his own trust with an identical distribution scheme but naming Jill a life beneficiary of the trust's income. Both Jill and William funded their trusts in identical amounts when Jill executed her trust agreement.

M. Wayne Davidson was the attorney who prepared the trusts for Jill and William. One of the purposes of William's trust was to make sure the assets in his trust were not included in his or Jill's taxable estates. Davidson proposed to Jill that she create her own trust to obtain gift tax benefits and to similarly assure that the assets in her trust were not included in William's taxable estate. Davidson drafted Jill's trust with those objectives in mind. To that end, Jill's trust agreement provided that “no part of this Trust shall be included in the Grantor's gross estate for death tax purposes.” At the time Jill executed the trust agreement, she believed it contained the necessary provisions for the trust assets to be excluded from her and William's taxable estates, and for the transfers to the trust to be considered completed gifts.

But because of a drafting error, Davidson failed to include two provisions necessary to differentiate the benefits provided to William under Jill's trust from the benefits provided to Jill under William's trust. These provisions were necessary to avoid the two trust being considered reciprocal, resulting in the assets of Jill's trust being included in William's estate upon his demise and vice versa. One of the provisions that was erroneously omitted from Jill's trust agreement would have enabled William to annually receive $5,000 or 5% of the assets in Jill's trust. The other provision would have given William a lifetime special power of appointment over the trust assets in Jill's trust that would have enabled him to appoint all or any portion of the assets in Jill's estate to any person other than himself, his creditors, his estate, or the creditors of his estate. These provisions are commonly used by attorneys drafting trusts to avoid creating reciprocal trusts.

The trial court found that the scrivener had committed an error which the Kansas Supreme Court affirmed.

## **Ethical Obligation To Avoid Counseling Or Assisting A Client In A Criminal Or Fraudulent Situation**

. On April 29, 2020, the American Bar Association issued Formal Opinion 491. As background for the opinion, it notes:

In the wake of media reports,2 disciplinary proceedings,3 criminal prosecutions,4 and reports on international counter-terrorism enforcement and efforts to combat money-laundering, the legal profession has become increasingly alert to the risk that a client or prospective client5 might try to retain a lawyer for a transaction or other non-litigation matter that could be legitimate but which further inquiry would reveal to be criminal or fraudulent.6 For example, a client might seek legal assistance for a series of purchases and sales of properties that will be used to launder money. Or a client might propose an all-cash deal in large amounts and ask that the proceeds be deposited in a bank located in a jurisdiction where transactions of this kind are commonly used to conceal terrorist financing or other illegal activities.7 On the other hand, further inquiry may dispel the lawyer’s concerns.

[footnotes omitted]

The substance relevant to estate planners is as follows:

As set forth in Section II of this opinion, a lawyer who has knowledge of facts that create a high probability that a client is seeking the lawyer’s services in a transaction to further criminal or fraudulent activity has a duty to inquire further to avoid assisting that activity under Rule 1.2(d). Failure to make a reasonable inquiry is willful blindness punishable under the actual knowledge standard of the Rule. Whether the facts known to the lawyer require further inquiry will depend on the circumstances. As discussed in Section III, even where Rule 1.2(d) does not require further inquiry, other Rules may. These Rules include the duty of competence under Rule 1.1, the duty of diligence under Rule 1.3, the duty of communication under Rule 1.4, the duty to protect the best interests of an organizational client under Rule 1.13, the duties of honesty and integrity under Rules 8.4(b) and (c), and the duty to withdraw under Rule 1.16(a). Further inquiry under these Rules serves important ends. It ensures that the lawyer is in a position to provide the informed advice and assistance to which the client is entitled, that the representation will not result in professional misconduct, and that the representation will not involve counseling or assisting a crime or fraud. Section IV addresses a lawyer’s obligations in responding to a client who either agrees or does not agree to provide information necessary to satisfy the duty to inquire. Finally, Section V examines hypothetical scenarios in which the duty to inquire would be triggered, as well as instances in which it would not.

The opinion contains five examples, three of which easily could be directly relevant to an estate planner:

#3: A general practitioner in rural North Dakota receives a call from a long-term client asking her to form a limited liability company for the purpose of buying a ranch.52

#4: The general practitioner in rural North Dakota receives a call from a new and unknown prospective client saying that the client just won several million dollars in Las Vegas and needs the lawyer to form a limited liability company to buy a ranch.53

#5: A prospective client in New York City asks a general practitioner in a mid-size town in rural Georgia to provide legal services for the acquisition of several farms in rural Georgia. The prospective client tells the lawyer that he has made a lot of money in hedge funds and now wants to diversify his investments by purchasing these farms but says he doesn’t want his purchases to cause a wave of land speculation and artificially inflate local prices. He wants to wire money into the law firm’s trust account over time for the purchases. He asks the lawyer to create a series of LLCs to make strategic (and apparently unrelated) acquisitions.54

[footnotes omitted]

The opinion provides no discussion beyond references to the Am. Bar Ass’n Task Force On Gatekeeper Regulation And The Profession, Voluntary Good Practices Guidance For Lawyers To Detect And Combat Money Laundering And Terrorist Financing.

## **No-Contest Clause Applied**

. Missouri has a statute allowing a “test” lawsuit over a no-contest clause. In Knopik v. Shelby Investments, LLC, 597 S.W.3d 189 (Mo. 2020), the beneficiary ignored that statute and just filed a lawsuit alleging a breach by the trustee. The court applied the no-contest clause:

Gift L.L.C. (“Settlor”) created the Knopik Irrevocable Trust (“Trust”) in late December 2016. The provisions of the Trust established Shelby Investments, L.L.C. (“Trustee”) as the sole trustee and Samuel Knopik (“Beneficiary”) as the sole beneficiary of the Trust. The Trust was to provide the Beneficiary with a $100-per-month distribution, beginning in December 2016 and ending in December 2020. Provision 12 of the Trust, denominated “No Contest,” provided:

In case any beneficiary shall (i) contest the validity of this trust, or any provisions hereof, in whole or in part; (ii) make a claim against a trustee for maladministration or breach of trust; or (iii) attempt to remove a trustee for any reason, with or without cause; then such contest or claim and such attempt shall cancel and terminate all provisions for or in favor of the beneficiary making or inciting such contest or claim, without regard to whether such contest or claim shall succeed or not; and all and any provisions or provision herein in favor of the beneficiary so making such contest or claim, or attempting or inciting the same, to be revoked and of no force and effect; and the entire trust estate shall revert to the Settlor and be distributed to the Settlor.

The Trustee made a single distribution to the Beneficiary in February 2017 but made no further distributions pursuant to the terms of the Trust. In August 2017, the Beneficiary filed a petition against the Trustee for breach of trust and to remove the Trustee. The Trustee admitted it made the single payment pursuant to the Trust, despite additional distributions being required. The Trustee further admitted it had indicated to the Beneficiary that it did not intend to make any future payments pursuant to the Trust. The Trustee also raised a counterclaim for declaratory judgment, asking the circuit court to determine that, due to the violation of the “No Contest” provision of the Trust, all provisions of the Trust in favor of the Beneficiary were cancelled and terminated. The Beneficiary and the Trustee each filed motions for summary judgment. The circuit court entered summary judgment in favor of the Trustee on its counterclaim after finding that the Beneficiary’s filing of his petition for breach of trust and removal violated the Trust’s no-contest clause. The Beneficiary appeals.

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There is no doubt that the language of the Trust indicated the Settlor’s clear intent to impose the result of forfeiture when the Beneficiary filed his petition. Provision 12 of the Trust purported to require forfeiture if the Beneficiary were to contest the validity of the Trust, make a claim against the Trustee for maladministration or breach of trust, or attempt to remove the Trustee for any reason. The petition the Beneficiary filed in the circuit court contained two counts. Count I was titled “Breach of Trust.” Count II – “Removal” – sought removal of the Trustee and proposed a replacement trustee. When the Beneficiary filed his petition, violation of the plain language of Provision 12 was evident. The circuit court found the filing of the petition, as pleaded, to be in violation of the Trust’s no-contest provision, and the circuit court ordered that all provisions of the Trust in favor of the Beneficiary be cancelled and terminated. The Beneficiary asks for relief by having this Court rule that no-contest clauses are inapplicable when the action is for breach of trust or removal of a trustee.

However, if the Beneficiary wished to challenge the enforceability and applicability of the no-contest clause to the claims in his petition, he should have done so in a proceeding under section 456.4-420. Section 456.4-420, enacted by the Missouri legislature in 2014, addresses a procedure by which an interested person can seek to avoid the effect of no-contest clauses in trusts. The statute provides “for an interlocutory determination whether a particular ... petition ... by the interested person would trigger application of the no-contest clause or would otherwise trigger a forfeiture that is enforceable under applicable law and public policy.” Section 456.4-420.1. Upon consideration of the language of the clause, the relationship of the clause to the trust instrument, and the facts of the petition, the circuit court makes a determination that “result[s] in the no-contest clause being enforceable to the extent of the court’s ruling.” Section 456.4-420.4. This determination is subject to appeal. Section 456.4-420.3.

Section 456.4-420 provided a “safe harbor” in which the Beneficiary should have invoked a challenge to the enforceability and applicability of the no-contest clause to his claims for breach of trust and removal. But the Beneficiary chose to file his petition asserting the exact claims the Trust unambiguously stated would result in forfeiture. Because of the Beneficiary’s failure to utilize section 456.4-420, this Court need not reach the issue of either delineating specific exceptions to the application of no-contest clauses or deciding whether a good faith or probable cause exception should be introduced in Missouri.

The court seems to base this tough result for the beneficiary on the beneficiary’s failure to start with a different statute, but suppose the beneficiary had asked the clause would apply and the court had said yes? The beneficiary would have been without a remedy. Why Missouri would enforce a trust with so few – maybe no – limits on a trustee is uncertain. A concurrence hints of a backstory that reflects poorly on the court and litigants:

It has been suggested that the present case is fictitious or collusive. *See* Kimberly E. Cohen, et al. *Advanced Estate Planning Practice Update: Summer 2019* (American Law Institute June 12, 2019) (quoted portion authored by Kathleen R. Sherby) (setting forth the circumstances surrounding this case and concluding: “Based on the circumstantial evidence gathered thus far, *Knopik* appears to be a ‘contrived’ case, put together by the two disappointed lawyers in [a prior matter].”). The author of this suggestion makes a compelling case but uses facts and inferences both within and outside the record now before this Court. This Court, on the other hand, has authority to dismiss an appeal on the ground that the case is fictitious or collusive only if the record before the Court demonstrates this is so. *State ex rel. Chandler v. McQuillin*, 229 Mo. 523, 130 S.W. 9, 12 (Mo. 1910); *Hahn*, 36 S.W. at 665-66. Here, the record falls short of that standard, and the Court declines to inquire of the parties and their counsel further on this issue.

It is devoutly to be hoped, however, that this case – and the ramifications and remedies that will flow from the pursuit of a fictitious or collusive suit, though they were not invoked here – come to mind the next time counsel or their clients consider feigning a dispute (or the appearance of one) merely for the purpose of securing an advisory opinion.

## **Self-Settled Trust Does Not Become Protected From Creditors After the Settlor’s Death**

. De Prins v. Michaeles, 154 N.E.3d 921 (Ma. 2020), is a decision in response to a question certified by the First Circuit. It involves sad facts, namely the efforts of a murder victim’s estate to recover in a wrongful death action against an irrevocable trust created and funded by the decedent four months before the decedent murdered the victim (actually husband and wife). The settlor-decedent was sole beneficiary of the trust.

Massachusetts has adopted the Uniform Trust Code which the court determined was silent on the question, thus requiring the application of common law. The court held that the settlor’s death would not affect the asset protection status of a self-settled trust. The opinion discusses the UTC provision this way:

Section 505 (a) (2) addresses a creditor's ability to reach the assets of an irrevocable trust. It does not specify whether it applies only during a settlor's lifetime or whether it applies after a settlor's death. G. L. c. 203E, § 505 (a) (2). It provides that, where a settlor has created an irrevocable trust, including one that contains a spendthrift provision, a creditor “may reach the maximum amount that can be distributed to or for the settlor's benefit.” Id. Where a settlor may reach the assets of an irrevocable trust, the settlor's creditors may also reach those assets. Therefore, as the defendants concede, if Belanger were still alive today, the plaintiff could reach the entirety of the trust's assets because the defendant trustee could, under the express terms of the trust, distribute all such assets to Belanger or for Belanger's benefit.

Because it is unclear from the statutory language whether § 505 (a) (2) addresses a creditor's ability to reach the assets of an irrevocable trust after the settlor's death, we look to the other sections of the statute as well as the legislative history. See Ciani, 481 Mass. at 178, 114 N.E.3d 52; Rotondi, 463 Mass. at 648, 977 N.E.2d 1042. When Massachusetts was considering adopting the Uniform Trust Code, an ad hoc committee was created to review and revise it for adoption. Report of the Ad Hoc Massachusetts Uniform Trust Code Committee 1-2 (rev. Jul. 18, 2012) (Report). The committee's comment to G. L. c. 203E, § 505, however, does not shed any additional light as to whether § 505 (a) (2) was intended to allow a creditor to reach an irrevocable trust's assets after the settlor's death or only during the settlor's lifetime.

Looking to the other provisions in the statute, G. L. c. 203E, § 106, provides that the MUTC is to be supplemented by the “common law of trusts and principles of equity.” The committee's comment to this section further clarifies that “the [MUTC] is not intended to replace the common law of trusts in Massachusetts except where the [MUTC] modifies it.” Report, supra at 7. It is clear, then, that the common law continues to apply where the MUTC does not address the situation at issue, and that the court may apply “principles of equity” to such cases. See G. L. c. 203E, § 106. In accordance with principles of equity, two sections of the MUTC specify that a trust may not be created that is contrary to public policy. See G. L. c. 203E, §§ 105 (b) (3), 404.

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Given the authorities discussed above, to the extent that a trust is self-settled such that the settlor retains the beneficial interest in the trust's assets and does not give such interest to another, it appears that the committee did not intend the MUTC to apply.

In accordance with settled principles of statutory construction, and because the MUTC both (1) expressly provides that it does not replace the common law and (2) fails to address the situation here (i.e., the ability of a creditor to reach the assets of an irrevocable self-settled trust after the settlor's death), we conclude that the common law applies.

Does it matter that the settlor retained no right to modify the trust? Massachusetts law was not entirely clear:

Here, the defendant trustee relies on State Street Bank & Trust Co. v. Reiser, 7 Mass. App. Ct. 633, 638-639, 389 N.E.2d 768 (1979) (Reiser), for the proposition that a creditor may only reach and apply assets of a discretionary trust after the settlor's death where the settlor reserved the power to amend or revoke the trust and direct the disposition of the trust's assets (i.e., where the trust was revocable). In Reiser, the plaintiff creditor sought to reach and apply trust assets of a revocable trust of a deceased settlor to satisfy a debt owed by the settlor's estate. Id. at 633, 389 N.E.2d 768. The settlor died before repaying the debt, and his estate had insufficient funds to pay it. Id. at 634, 389 N.E.2d 768. The Appeals Court held that the creditor could reach and apply the trust's assets to satisfy the debt. Id. at 638-639, 389 N.E.2d 768. On the facts, the holding of the court in Reiser is merely illustrative of one instance in which a creditor was allowed to reach the assets of a trust of a deceased settlor.12 It does not define the limits of a creditor's ability to so reach.

In another Appeals Court case, a creditor was allowed to reach the assets of an irrevocable spendthrift trust to satisfy a judgment in a personal injury action against the deceased beneficiary's estate because the trust was held to be self-settled. Calhoun v. Rawlins, 93 Mass. App. Ct. 458, 459, 464-465, 106 N.E.3d 684 (2018). The beneficiary allegedly caused an automobile collision that seriously injured the plaintiffs and resulted in the beneficiary's death. Id. at 461, 106 N.E.3d 684. In that case, the court focused on the trustees' “complete discretion to distribute” trust assets to the beneficiary or for his benefit. Id. at 460-461, 106 N.E.3d 684. Although the court did not address the effect of the beneficiary's death on the creditor's ability to reach the trust property, it necessarily assumed that the creditor was not \*49 prohibited from such reach, as the cause of action giving rise to the personal injury action in which the plaintiffs received judgment accrued simultaneously to the beneficiary's death. Id. at 461, 106 N.E.3d 684.

On balance, the court held for the creditors:

Although we have found no case law that directly discusses the distinction between the reachability of the assets of a self-settled trust during the settlor's lifetime versus after his death (if one exists), it would be incongruent for a self-settled trust not to protect a settlor's assets from creditors while the settlor is alive but to have it protect the settlor's beneficiaries from the settlor's creditors after the settlor's death when, absent the self-settled trust, they would not be so protected. We therefore hold that a self-settled trust does not become protected from creditors on the settlor's death.

Although the plaintiff does not argue that the conveyance of Belanger's assets to the trust was fraudulent, the timing of the events could give rise to the inference that it was part of a single plan. The De Prinses brought and prevailed in a lawsuit against Belanger in 2007. Belanger's wife committed suicide on October 4, 2008. Within six months of her suicide, Belanger created the trust, transferred substantially all of his assets to the trust, murdered the De Prinses, and then committed suicide.

The defendant argues that Belanger did not have an estate to live on but not one from which to pay his debts, because the defendant did not distribute any trust assets to Belanger prior to his death. According to the defendant's argument, now that Belanger is deceased, it would be impossible for the defendant to distribute any trust assets to Belanger or for Belanger's benefit, so this is not a case where Belanger is able to “have his cake and eat it too.” As the First Circuit correctly observed, however, the important point is what is within the trustee's power to do, not what he actually does. Tilcon Capaldi, Inc., supra at 60 (“Thus, even if the trustee chooses not to make any payments to the beneficiary, a creditor may still reach the maximum amount the trustee could pay”). In other words, although the defendant did not distribute any trust assets to Belanger during his lifetime, he could have under the express terms of the trust. Therefore, under the First Circuit's reasoning, the plaintiff should be able to reach the maximum amount the defendant could have distributed during Belanger's lifetime -- all the assets of the trust. See [id.](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=2001405624&pubNum=0000506&originatingDoc=I403f54d012f211eb8cddf39cfa051b39&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation))

Further, often one of our greatest goals in life is to leave our children the benefit of our property. To prevent the son of two murder victims from financially recovering for their wrongful deaths while protecting the murderer's assets for his beneficiary would contradict the well-established public policy of this Commonwealth and condone the actions of a settlor who, it can be inferred, thought he could use the protection of a trust to shield his assets from the consequences of his violence. The equities here simply do not allow Belanger to murder the plaintiff's parents and then leave the plaintiff with no recovery in the subsequent wrongful death action, despite Belanger's possessing substantial assets during his lifetime.

## **Gifts From Revocable Trust Made By Settlor**

. In re Estate of Marsh, 951 N.W.2d 486 (Ne. 2020) is a state inheritance tax case dealing in part with the ownership of interests in an LLC called Marcasa. Mr. Marsh, grantor of his revocable trust, gave LLC interests to his beneficiaries even though the trust owned the interests. The trial court held the gifts were valid and the Nebraska Supreme Court agreed. The opinion states:

In January 2008, Marsh executed eight assignment forms in his individual capacity. Then, in May, Marsh assigned his interest in Marcasa to his trust. Thereafter, the assignment forms executed between 2009 and 2013 showed that they were signed by Marsh as grantor of the trust.

To make a valid inter vivos gift, there must be an intention to transfer title to property, delivery by the donor, and acceptance by the donee. The first two elements relate to intent and actions of the donor. The donor must have a present donative intent and a clear and unmistakable intent to make a gift. Ordinarily, actual delivery is necessary where the subject of the gift is capable of manual delivery, but where actual manual delivery cannot be made, the donor may do that which, under the circumstances, will in reason be considered equivalent to actual delivery. The Ninth Circuit explained that interests in a limited liability company “do not lend themselves to manual delivery. Instead, they are delivered through the execution of papers. As a result, ... it is somewhat artificial to separate the ‘delivery’ of [a limited liability company] interest from the intention to donate it.” Here, intent and delivery are demonstrated by Marsh's history of assigning interests to his daughters and their family members, his execution of the assignments, and his cessation of acting as the owner of those interests after execution of the assignments.

The final element of a gift calls for action by the donee. The exercise by the donee of dominion over the property which is the subject of a gift, or an assertion of a right to the property by the donee, generally will constitute an acceptance.  The donees accepted the gifts by acting as the rightful owner of the interests in Marcasa, and their ownership took effect immediately. Their interests were reported on Schedule K-1 tax forms, thereby subjecting them to payment of income taxes attributable to their ownership interests.

The County contends that no transfer of ownership interests occurred, because the cotrustees never executed any of the transfer documents. But under the trust agreement, Marsh retained authority “to withdraw property from the trust.” The trust agreement provided the manner to do so—“by an instrument in writing signed by the Settlor and delivered to the Trustee in the lifetime of the Settlor.” Here, the assignments at issue were all in writing. And the cotrustees, as either the recipients or the spouses or parents of the recipients, were aware of the assignments. Further, we have stated that whether a deed or other instrument conveying an interest in property has been delivered is largely a question of intent to be determined by the facts and circumstances of the particular case.[31](https://1.next.westlaw.com/Document/I69fb7f00365211eba9c4c2beee9e04d0/View/FullText.html?transitionType=UniqueDocItem&contextData=(sc.UserEnteredCitation)&userEnteredCitation=951+N.W.2d+486#co_footnote_B00312052508038) Marsh's parting with the ownership interests given as gifts and the cotrustees and other donees acting as owners of those respective interests manifest evidence of delivery. The court's decision conforms to the law, is supported by competent evidence, and is not unreasonable.

## **No “Adoption Out” Under Indiana Trust**

. Mildred had a son, Charles, who married Ann. Mildred created an irrevocable trust paying income to Charles, then Ann, then Charles’ descendants, per stirpes, and another similar testamentary trust. Charles and Ann had David, who married Joan, and they had three children, Brittany, Matthew, and Molly. David and Joan divorced, Joan married Thomas, who adopted Brittany, Matthew and Molly. The question in Walters v. Corder, 146 N.E.3d 365 (In. App. 2020), was whether the three adopted children remained beneficiaries of Mildred’s trusts. The court held that in Indiana the answer is yes:

We begin with the language that created the trust. Upon David's death, his share of the trust is to be divided among his living children. The term “children” is not defined in the terms of the trust, and the term is not qualified or restricted in any way (other than requiring the children to be “living”). Further, the trust language is silent as to adopted children—whether adopted in or out of the family. At the time Mildred included in her will the Testamentary Trust in 1991, the Indiana Trust Code did not define the term “children.”[1](https://1.next.westlaw.com/Document/I545c1ce079f611ea9e3ceb5de751016b/View/FullText.html?transitionType=UniqueDocItem&contextData=(sc.UserEnteredCitation)&userEnteredCitation=146+N.E.3d+965#co_footnote_B00012050733562) Further, caselaw indicates that the ordinary, popular, and legal sense of the word “children” embraces the first generation of offspring. [Casper v. Helvie, 83 Ind. App. 166, 146 N.E. 123, 127 (1925)](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1925111533&pubNum=0000577&originatingDoc=I545c1ce079f611ea9e3ceb5de751016b&refType=RP&fi=co_pp_sp_577_127&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_577_127). All four of David's offspring were living at the time of his death.

We now turn to the circumstances existing at the time Mildred executed her will establishing the Testamentary Trust in 1991. David was married to his first wife, Joan, and they had only one child, Brittany. During the course of their marriage, and while Mildred was alive, David and Joan had their second child, Matthew, in 1992. When Mildred died in 1994, David and Joan were still married, and Joan was pregnant with their third child, Molly. Moreover, the unrefuted designated evidence shows that, prior to her death, Mildred knew that Joan was pregnant with a third child, and that Mildred had a close relationship with both Brittany and Matthew during her lifetime. Mildred never knew that David and Joan got divorced or that David consented to the adoption of Brittany, Matthew, and Molly; these events all occurred after Mildred's death.

As we did with her Testamentary Trust, we examine Mildred's intent with regard to the Irrevocable Trust. The term “issue” is not defined by the terms of the trust, and, other than requiring the issue to be twenty-one, the language of this provision does not restrict or limit the term or create a separate class for adopted children. The document is silent with regard to issue that may be adopted in or out of the family. The term “issue” is not defined in the trust code, but it has been defined in caselaw as meaning “descendants.” [Allen v. Craft, 109 Ind. 476, 9 N.E. 919, 922 (1887)](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1887166440&pubNum=0000577&originatingDoc=I545c1ce079f611ea9e3ceb5de751016b&refType=RP&fi=co_pp_sp_577_922&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_577_922);see also Black's Law Dictionary (11th ed. 2019) (defining “issue” as lineal descendants; offspring). Here, David was a descendant of Charles, and Brittany, Matthew, Molly, and Raquel are all descendants or offspring of David.

As to the facts and circumstances existing at the time Mildred established this trust in 1968, we have little information. David was only eight years old so Mildred had no knowledge of whether he would marry and/or have children. Beyond that information, there is no evidence that Mildred intended to exclude any of her descendants from this class of beneficiaries.

\* \* \*

The courts of our state have made it abundantly clear that the settlor's intent is the sovereign guide in the interpretation of the terms of a trust. See, e.g., Doll v. Post, 132 N.E.3d 34, 38 (Ind. Ct. App. 2019) (primary purpose in construing trust is to ascertain and give effect to settlor's intention), trans. denied (2020). We have before us no evidence of an intent on the part of Mildred to exclude her three eldest grandchildren from membership in the classes of beneficiaries of these two trusts merely because her grandson gave his consent to their adoption by their stepfather after Mildred's death. Therefore, we determine that, despite the fact that the O'Brien Children were adopted out of the Walters family, they retain their status as beneficiaries in the two trusts as the “children” of David and the “issue” of David's father.

David’s daughter, by his second marriage, Raquel, was the objecting party. Her argument was that Indiana adoption and probate law required a different result:

The purpose of [Section 31-19-15-1](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000009&cite=INS31-19-15-1&originatingDoc=I545c1ce079f611ea9e3ceb5de751016b&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) “ ‘is to shield the adoptive family from unnecessary instability and uncertainty arising from unwanted intrusions by the child's biological family.’ ” [In re Adoption of J.T.A., 988 N.E.2d 1250, 1253 (Ind. Ct. App. 2013)](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=2030697290&pubNum=0000578&originatingDoc=I545c1ce079f611ea9e3ceb5de751016b&refType=RP&fi=co_pp_sp_578_1253&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_578_1253) (quoting [In re Adoption of K.S.P., 804 N.E.2d 1253, 1257 (Ind. Ct. App. 2004)](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=2004248722&pubNum=0000578&originatingDoc=I545c1ce079f611ea9e3ceb5de751016b&refType=RP&fi=co_pp_sp_578_1257&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_578_1257)), trans. denied. Here, the O'Brien Children are all adults, and the biological family is not trying to interfere with any aspect of the relationship between them and their adoptive family. Rather, their biological great grandmother, with whom two of the three O'Brien Children[2](https://1.next.westlaw.com/Document/I545c1ce079f611ea9e3ceb5de751016b/View/FullText.html?transitionType=UniqueDocItem&contextData=(sc.UserEnteredCitation)&userEnteredCitation=146+N.E.3d+965#co_footnote_B00022050733562) had contact and a relationship from their birth until her death, included them as beneficiaries of her trusts. Although Raquel claims that a determination that the O'Brien Children are beneficiaries under the terms of Mildred's trusts would “undermine the purpose of the adoption statutes,” we disagree. Appellant's Br. p. 20. The objective of [Section 31-19-15-1](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000009&cite=INS31-19-15-1&originatingDoc=I545c1ce079f611ea9e3ceb5de751016b&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) is not advanced by depriving the O'Brien Children of their status as beneficiaries merely because their biological father consented for them to be adopted after the death of the settlor of the trusts. The statute was designed as a shield to protect new adoptive families, not as a sword to prohibit adopted children from receiving a trust distribution, per the settlor's wishes, from a member of the family from which the children have been adopted out. Indeed, allowing this statute to be used in such a manner would contravene one of the cardinal principles of trust law: the settlor has the right to arrange for the distribution of her estate as she sees fit. [Paloutzian v. Taggart, 931 N.E.2d 921, 925 (Ind. Ct. App. 2010)](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=2022768372&pubNum=0000578&originatingDoc=I545c1ce079f611ea9e3ceb5de751016b&refType=RP&fi=co_pp_sp_578_925&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)#co_pp_sp_578_925) (citing Jay M. Zitter, Annotation, [Adopted Child as Within Class Named Deed or Inter Vivos Instrument, 37 A.L.R.5th 237, § 2(a) (1996)).](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1996226257&pubNum=0004087&originatingDoc=I545c1ce079f611ea9e3ceb5de751016b&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation))

\* \* \*

In addition, Raquel contends that to conclude that the O'Brien Children are beneficiaries conflicts with both [Indiana Code section 29-1-2-8](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000009&cite=INS29-1-2-8&originatingDoc=I545c1ce079f611ea9e3ceb5de751016b&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) (1987) of the probate code and Section 6-4.1-1-3 (2012) of the tax [code. Section 29-1-2-8](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000009&cite=INS29-1-2-8&originatingDoc=I545c1ce079f611ea9e3ceb5de751016b&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) provides that, for purposes of intestate succession, an adopted child will be treated as a natural child of the child's adopting parents and will cease to be treated as a child of the natural parents. Section 6-4.1-1-3 states that, for purposes of inheritance taxes, a legally adopted child is to be treated as if the child were the natural child of the child's adopting parent if the adoption occurred before the individual was totally emancipated. These statutes apply only to intestate distributions and inheritance taxes, respectively, and do not constitute rules of trust construction. For that reason, they are of no significance in ascertaining the intention of a settlor in designating his or her intended beneficiaries when the children were adopted out of the family after the death of the settlor. Stated another way, the question we are presented with is not whether the O'Brien Children would take as heirs if Mildred had died intestate or what class of transferee they are in for purposes of calculating inheritance tax due. Rather, the question is whether Mildred intended to include the O'Brien Children in the classes of beneficiaries when she used the term “children” in her Testamentary Trust and when she used the term “issue per stirpes” in her Irrevocable Trust.

## **The Ethics of Lawyers Working Remotely**

. The ethics pronouncements of the American Bar Association are not binding on attorneys or state regulatory authorities. Nonetheless, in the absence of other authority, they can be helpful. On December 16, 2020, the ABA issued Formal Opinion 495 which reaches a common-sense conclusion:

The purpose of Model Rule 5.5 is to protect the public from unlicensed and unqualified practitioners of law. That purpose is not served by prohibiting a lawyer from practicing the law of a jurisdiction in which the lawyer is licensed, for clients with matters in that jurisdiction, if the lawyer is for all intents and purposes invisible as a lawyer to a local jurisdiction where the lawyer is physically located, but not licensed. The Committee’s opinion is that, in the absence of a local jurisdiction’s finding that the activity constitutes the unauthorized practice of law, a lawyer may practice the law authorized by the lawyer’s licensing jurisdiction for clients of that jurisdiction, while physically located in a jurisdiction where the lawyer is not licensed if the lawyer does not hold out the lawyer’s presence or availability to perform legal services in the local jurisdiction or actually provide legal services for matters subject to the local jurisdiction, unless otherwise authorized.

Of course, the out-of-state lawyer must not represent to clients or the public that the lawyer is admitted to practice in the remote jurisdiction. That would be prohibited by Model Rule 5.5(b)(2).

The Florida Supreme Court has issued an opinion (2021 WL 2006584) stating that an attorney not licensed in Florida may reside in Florida and do legal work for the lawyer’s non-Florida clients. The facts dealt with were these:

He is licensed to practice law in New Jersey, New York, and before the United States Patent and Trademark Office (hereinafter “USPTO”). He is not licensed to practice law in Florida. He recently retired from his position as chief IP counsel for a major U.S. Corporation. That position was in New Jersey. He moved from New Jersey to Florida. He started working as an attorney with a New Jersey law firm specializing in federal IP law. The firm has no offices in Florida and has no plans to expand its business to Florida. His professional office will be located at the firm's business address in New Jersey, although he will do most of his work from his Florida home using a personal computer securely connected to the firm's computer network. In the conduct of his employment with the firm, he will not represent any Florida persons or entities and will not solicit any Florida clients. While working remotely from his Florida home, he will have no public presence or profile as an attorney in Florida. Neither he nor his firm will represent to anyone that he is a Florida attorney. Neither he nor his firm will advertise or otherwise inform the public of his remote work presence in Florida. The firm's letterhead and website, and his business cards will list no physical address for him other than the firm's business address in New Jersey and will identify him as “Of Counsel – Licensed only in NY, NJ and the USPTO.” The letterhead, website, and business cards will show that he can be contacted by phone or fax only at the firm's New Jersey phone and fax number. His professional email address will be the firm's domain. His work at the firm will be limited to advice and counsel on federal IP rights issues in which no Florida law is implicated, such as questions of patent infringement and patent invalidity. He will not work on any issues that involve Florida courts or Florida property, and he will not give advice on Florida law.

## **Decanting**

. In Hodges v. Johnson, 177 A.3d. 86 (N.H. 2017), two irrevocable trusts were established in 2004 for the benefit of the grantor’s wife, children, step-children and other descendants. The Trustees had a discretionary power to “distribute all or any portion of the net income and principal of the trust to any one or more of the group consisting of [the beneficiaries] and distributee trusts, in such amounts and at such times as the Trustee, in the Trustee’s discretion, may determine.” “Distributee trusts” were defined as any trust under the trust instruments or any other trust established by the grantor. A distributee trust could be for the benefit of one or more, “but not necessarily all,” of the beneficiaries.

The Trustees of the two irrevocable trusts decanted trust assets into new trusts and eliminated the grantor’s two step-children and one of his biological children from the definition of “descendants” in the new trust instruments, effectively stripping their interests in the trusts. The trust assets were not transferred to the new trusts. The decanting documents provided for the transfer of trust assets upon the settlor’s death. Because the parties never made arguments regarding the failure to transfer the assets, both the trial court and the Supreme Court of New Hampshire treated the decantings as if they had occurred when decanting documents were executed and that the failure to transfer assets did not render the decantings invalid.

Under New Hampshire’s decanting statute, if a Trustee has the power to make discretionary distributions of principal to one or more beneficiaries, the Trustee may decant the assets to a new trust that eliminates one of those beneficiaries as a beneficiary of the new trust. The statute further provides that “[i]n exercising the power to decant, a trustee has a duty to exercise the power in a manner that is consistent with the settlor’s intent as expressed in the terms of the trust, and the trustee shall act in accordance with the trustee’s duties under this chapter and the terms of the first trust.” RSA 564-B:4-418.

The trial court set aside the decantings and removed the Trustees. On appeal to the Supreme Court of New Hampshire, the court stated that even though New Hampshire’s decanting statute allowed the Trustees to eliminate beneficiaries, and even though the Trustees had the discretion to distribute income and principal in the Trustees’ discretion, the Trustees were still subject to the duty of impartiality in carrying out the decanting. The court stated that “a trustee, who makes unequal distributions among beneficiaries and/or eliminates a beneficiary’s non-vested interest in an irrevocable trust through decanting, violates the statutory duty of impartiality only when the trustee fails to treat the beneficiaries ‘equitably in light of the purposes and terms of the trust.’“ (quoting Uniform Trust Code § 803 Cmt.).

The court agreed with the trial court that the decantings were improper and void because the decantings violated the Trustees’ duty of impartiality by failing to consider the interests of all of the beneficiaries, both present and remainder. It is difficult to understand why a trustee would think it could decant under such circumstances.

The removed, former trustees asked to be reimbursed from the 2004 trusts for post-trial fees and costs they personally incurred defending the decantings, and asked not to be required to reimburse those trusts for the fees and costs the trusts incurred. The trial court found that the former trustees had committed a serious breach of trust and should not be granted the relief they sought. The Supreme Court of New Hampshire affirmed at Hodges v. Johnson, 244 A.3d 245 (N.H. 2020). The opinion states:

The Former Co-Trustees assert that the trial court “inappropriately relied” upon the fact that they did not file a petition for instruction. They argue that the trial court’s reliance was improper because: (1)the court “failed to establish a valid foundation or set out any criteria to support its assertion that [they] should have filed a petition”;(2) there “was no established law” suggesting that “their decision-making . . . was subject to doubt or conflicting claims”;(3) they needed to act expeditiously to prevent the plaintiffs and Joanne from acting detrimentally to the 2004 Trusts; (4) bringing a petition for instruction would have resulted in “hotly contested” and “expensive” litigation;(5) “[t]he decanting decision concerned contingencies that are not appropriate for a petition for instruction”; and( 6) even after Hodges, “we do not know how the Former Co-Trustees should have exercised their duty of impartiality.”(Emphases omitted.)

However, it is precisely when there is “uncertainty as to the proper application of the law to the facts” that a petition for instruction is warranted. Rock Springs Land and Timber, Inc. v. Lore, 75 P.3d 614, 623 (Wyo. 2003) (quotation omitted).Section 71 of the Restatement (Third) of Trusts provides: “A trustee . . . may apply to an appropriate court for instructions regarding the administration or distribution of the trust if there is reasonable doubt about the powers or duties of the trusteeship or about the proper interpretation of the trust provisions.” Restatement (Third) of Trusts, § 71 (2007). “A trustee commits a breach of trust not only by violating a duty as a result of negligence or misconduct but also, ordinarily, by violating a duty because of a mistake concerning the nature or extent of the trustee’s powers and duties under the terms of the trust or applicable law.” Id. cmt. a at 9 (citation omitted).Accordingly, “[t]o avoid undue risk of liability when reasonable doubt exists in these matters, a trustee may seek protection by applying for instructions from an appropriate court.” Id. Contrary to the Former Co-Trustees’ assertions,

a trustee need not act at his or her peril in administering a trust. Nor need a trustee act first and discover later whether a particular act was in breach of trust. Instead, a trustee is entitled to judicial instructions whenever there is reasonable doubt about the powers or duties of the trusteeship or about the proper interpretation of the trust provisions. Indeed, a trustee can properly pay the costs of seeking instructions out of the trust estate, unless seeking them was plainly unwarranted, because there was no reasonable uncertainty about the matter in question.

Austin Wakeman Scott, William Franklin Fratcher & Mark L. Ascher, Scott and Ascher on Trusts, § 16.8, at 1070-71(5th ed. 2007)(quotation omitted).

To the extent that the trial court concluded that the circumstances in this case should have caused the Former Co-Trustees to have reasonable doubt as to whether the decantings at issue were proper, we agree. Here, the decanting to exclude beneficiaries of irrevocable trusts were to be accomplished under circumstances suggesting that the settlor directed them so as to disinherit disfavored family members. Those circumstances should have caused the Former Co-Trustees to have reasonable doubt as to the propriety of the decantings.

Thus, we find no error in the trial court’s suggestion that, before participating in the decantings, the Former Co-Trustees could have filed a petition for instruction or obtained an independent legal opinion, instead of relying exclusively upon McDonald’s [settlor’s attorney] advice under circumstances suggesting that he was doing the settlor’s bidding to disinherit beneficiaries with whom the settlor was unhappy.

## **Entity Transparency**

. The National Defense Authorization Act, passed by Congress at the end of 2020 and beginning of 2021, contains the Corporate Transparency Act.  Of particular interest to estate planners is that entities created by a filing with a state Secretary of State (or similar state office) will need to begin filing beneficial ownership statements with the Financial Crimes Enforcement Network, two years after Treasury issues regulations on the matter.  A company with more than 20 full-time employees that files a US federal income tax return showing $5 million or more in gross receipts or sales, and that has a physical presence in the US, need not file, nor will charities and various other regulated businesses (banks, insurance companies, and the like) be required to file.  Although business trusts likely do have reporting requirements, thus far private trusts have no reporting obligations but those may be imposed at a future point.  Presumably general partnerships need not report because they are common law entities generally not required to make a filing under applicable state law.

Suppose a state wanted to assist entities that preferred not to make reports. If in such a state general partnerships lacked filing requirements then making general partnerships more attractive would seem to be desirable. The problem with general partnerships, from an estate planning point of view, is that they do not restrict management and liquidation rights as is required to obtain discounts, and, more generally, that they do not provide any party with limited liability. Traditionally limited liability and restricted management and liquidation could only be obtained via entities that require state “incorporation” or a similar step. In the case of limited liability the commonly stated reason is that the public ought to know, or be charged with knowing, of limited liability.

Suppose a state substituted a naming requirement for a filing requirement. For example, the state might provide that a general partnership, created without a filing, would be a traditional general partnership with unlimited liability unless it contained in its name, say, “Limited Liability.” A general partnership that contained “Limited Liability” in the name would have the limited liability of a limited liability corporation and would in all respects function as if were an LLC with all “general partners” as managers. For those clients who desired LLC benefits without the requirement of reporting, such an arrangement would be attractive. Quite obviously many other naming conventions could be adopted, for instance a “Special General Partnership” such that a traditional general partnership called Smith & Jones, SGP means it is formed as a general partnership, without formalities, but has adopted the LLC form of operation and liability.

## **Reformation of Special Needs Trust Allowed**

. The Valerie R. Pecce Supplemental Needs Trust incorrectly and unnecessarily provided that trust assets must first be used to reimburse the Massachusetts division of medical assistance for benefits provided to Valerie during her lifetime, before any remaining assets can be distributed to other 2001 trust beneficiaries. The issue in Matter of Valerie R. Pecce Supplemental Needs Trust, 99 Mass.App.Ct. 376 (Mass. App. 2021) was whether the trust should and could be reformed. The court concluded no as to assets transferred to the trust during settlor’s lifetime, but yes as to assets transferred from his estate. The opinion states:

To begin, we acknowledge that all parties agree that the 2001 trust is not, in fact, a (d)(4)(A) trust. A (d)(4)(A) trust must contain (at least in part) assets of the disabled individual; the 2001 trust does not contain any of Valerie's assets, and thus does not qualify as a (d)(4)(A) trust. Since the 2001 trust expressly states that it is “established” and shall be “administered” and “interpreted” as a (d)(4)(A) trust, that much of the trust document, at least, is a clear mistake.

While recognizing this error, the trial judge nevertheless refused to reform the 2001 trust because she determined that the payback provision in article 6.2 was not a mistake. In essence, the judge concluded that Albert had three purposes in establishing the 2001 trust: (1) to provide Valerie with assets to supplement her government benefits; (2) to ensure Valerie's continuing eligibility for Medicaid; and (3) to ensure Albert's Medicaid eligibility in the event that he sought such benefits within the applicable, three-year look-back period. She reasoned that the third of these purposes justified Albert's inclusion of the payback provision, because absent such a provision, any transfer by Albert to the 2001 trust would cause him to lose his Medicaid eligibility for three years. And after considering the trial evidence, the judge made an express finding to that effect: “The [c]ourt finds that the inclusion of the payback provision is not a mistake, but that Albert had a rational reason for creating the 2001 [t]rust with a payback provision, which was to ensure his eligibility for Medicaid.”

\* \* \*

Reformation of the 2001 trust with respect to assets transferred after Albert's death. We accordingly decline to overturn the judge's ruling, to the extent that it refused to strike the MassHealth payback provision from the 2001 trust. That is not the end of this matter, however. The judge's finding only supplies a basis for the payback provision to apply to transfers made by Albert while Albert was alive, and potentially in need of Medicaid. There was absolutely no need for the payback provision to apply to transfers made after Albert's death. Yet absent reformation, the payback provision of the 2001 trust would apply even to assets transferred to the 2001 trust as a result of the pour-over clause of Albert's will.

We conclude, based upon the operative documents and the judge's findings, that reformation of the 2001 trust is appropriate to prevent the payback provision from applying to assets transferred after Albert's death. As the judge found, there clearly was a “mistake” in the “expression” of the 2001 trust documents. G. L. c. 203E, § 415. The drafter misidentified the legal basis for the 2001 trust, and carried that mistake through several sections of the trust document. The statutory predicate for reformation is thus established. The drafter's error was compounded, moreover, by the will provision that poured over Albert's remaining assets to the 2001 trust at his death. These errors have led to exposing Albert's entire estate to reimbursement to MassHealth.

Albert would not have intended that his estate assets go to the Commonwealth, where they could otherwise go to the beneficiaries he identified from his family. Under the circumstances, where a mistake is clear in a trust document and where the result of the mistake is evidently at odds with the settlor's intent, reformation is called for. In that regard, we think this case is not unlike First Agric. Bank v. Coxe, 406 Mass. 879, 882, 550 N.E.2d 875 (1990), in which the Supreme Judicial Court concluded that it was appropriate to reform a settlor's will and trust documents, and to separate certain assets in a trust so as to avoid Federal generation skipping transfer (GST) taxes with respect to those separated assets. The court concluded: “We have no doubt that the circumstances the trustee has presented warrant our issuing a declaratory statement or instruction concerning the authority of the trustee to separate Trust A assets in some way so that the GST tax will not apply to [certain trust] distributions....” [Id.](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1990048221&pubNum=0000521&originatingDoc=Ie2cb7a40923511ebb814920ee3be9aa4&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) A similar course is appropriate here. On remand, the judge should reform the trust document, to ensure that assets transferred to the 2001 trust from Albert's estate are not subject to the article 6.2 payback provision. The judge should also make such changes as are necessary to ensure that the language referencing (d)(4)(A) no longer has operative effect, in line with the finding that the identified legal basis for the trust was clearly a mistake.

## **Exercise of Power of Appointment**

. The effect of an attempted exercise of a power of appointment was in question in Wilmington Trust Company as Trustee of the A. Felix Du Pont Trust v. James Paul Mills Jr. et. al, 2021 WL 2620585 (Del. Ch. unreported). A 1934 trust gave Alice Du Pont this power of appointment:

Upon the death of Trustor's said daughter, Alice F. du Pont, Trustee shall assign, transfer, convey and deliver this trust fund, principal and undistributed income thereof, if any, free from this trust, unto the widower of said Alice F. du Pont, and/or unto the lawful issue of said Alice F. du Pont, in such manner and amounts and upon such trusts, terms and conditions as said Alice F. du Pont shall have appointed by the last instrument in writing which she shall have executed and delivered during her lifetime to Trustee, or failing such instrument in her last Will and Testament, or in default of any such appointment then unto her living issue, if any per stripes not per capita. ...

Pet. Ex. A § 1 (the “Original Limited Power”).

Alice had three children, Phyllis, James, and Mary. Phyllis was in an accident and was unlikely to have children; Alice exercised her power several times, in 1986 for the last time, which the court described as follows:

Alice exercised the Original Limited Power for the final time in an instrument dated July 25, 1986. Pet. Ex. B (the “1986 Exercise”). In that instrument, Alice continued to treat Phyllis differently than James and Mary.

Like the prior exercises, the 1986 Exercise provided that upon Alice's death, the Trustee would divide Trust No. 2108 into equal shares, one for each of Alice's surviving children, and hold each share as a separate trust. The 1986 Exercise also retained the basic framework of the Second Limited Power, framed in terms substantively identical to the 1983 Exercise. The 1986 Exercise also retained the Adopted Child Proviso.

Like the 1983 Exercise, the 1986 Exercise supplemented the Second Limited Power with a proviso that purported to empower Phyllis to designate a charity as the recipient of her share of Trust No. 2108. The 1986 Exercise, however, added the phrase “to the extent permissible” to the text. The language now read:

[P]rovided, however, that *to the extent permissible* Grantor's daughter PHYLLIS may exercise any power conferred upon her under this subparagraph in favor of any organization or organizations to which deductible contributions may be made for purposes of federal income or estate tax laws, as well as in favor of her issue, but subject to the limitations contained in Paragraph (d) of this Article SECOND.

*Id.* art. SECOND, ¶ (a)(1)(D) (the “Second Charitable Proviso”) (emphasis added).

Like the earlier instruments, the 1986 Exercise contained a Default Provision. Unlike the earlier instruments, and consistent with the addition of the phrase “to the extent permissible” to the Second Charitable Proviso, the 1986 Exercise added language to address a failure to exercise the Second Limited Power fully and effectively. The Default Provision in the 1986 Exercise reads as follows:

*To the extent a child of Grantor does not fully and effectively appoint*, the trust property, *to the extent not fully and effectively appointed*, shall be distributed to the issue, per stirpes, of such deceased child, subject to the provisions of Article FOURTH; provided, however, that any share of such property passing to any child of such deceased child of Grantor shall be held in further trust. ... *To the extent a child of Grantor does not fully and effectively appoint* and is not survived by issue, such property *to the extent not effectively appointed* shall be distributed to the then surviving issue of Grantor, per stirpes, subject to the provisions of Article FOURTH....

*Id.* art. SECOND, ¶ (a)(1)(D) (the “Final Default Provision”).

Like the earlier exercises, the 1986 Exercise contained a Perpetuities Provision. The terms of the Perpetuities Provision in the 1986 Exercise were substantively identical to the corresponding provision in the 1983 Exercise.

The Trustee executed the 1986 Exercise in its capacity as trustee, thereby acknowledging its existence. The Trustee also agreed to “act in accordance with its terms.” Mills Reply Br. Ex. B at 18.

Alice died in 2002 and in 2006 Phyllis attempted to exercise the power of appointment she had been given by Alice. This exercise the court described like this:

The 2006 Exercise recognized the limited scope of the Original Limited Power. In a WHEREAS clause, it described that power of appointment accurately as follows:

[M]y grandfather conferred upon my mother a limited power to appoint the principal and undistributed income of Trust No 002108 as of the date of her death to and among her widower and/or her lawful issue in such manner and amounts and upon such trusts, terms and conditions as she appointed by the last instrument in writing that she executed and delivered during her lifetime to Trustee, or failing any such instrument, then by her Last Will and Testament....

Pet. Ex. C at 1. The 2006 Exercise thus recognized that the scope of the Original Limited Power extended only to Alice's widower and lawful issue; it did not contain a grant of authority comparable to the Second Charitable Proviso.

The 2006 Exercise also recognized that the source of the Second Charitable Proviso was the 1986 Exercise. Another WHEREAS clause described the power of appointment granted by that instrument as follows:

[I]n Article SECOND (a)(1)(D)) of the instrument dated July 28, 1986, my mother conferred upon me a limited power to appoint the principal and undistributed income of my one-third share of Trust No 002108 held for my benefit in favor of my issue, or in favor of any organization or organizations to which deductible contributions may be made for purposes of federal income or estate tax laws, as I shall have appointed effectively by the last instrument in writing which I shall have executed and delivered to Trustee during my lifetime, or failing any such instrument, then by my Last Will and Testament.

*Id.* at 1-2. The 2006 Exercise thus captured the conflict between the Original Limited Power and the Second Charitable Proviso.

In the 2006 Exercise, Phyllis provided that the corpus of the Phyllis Trust would pass on her death, free from trust, to The Wyeth Foundation (the “Foundation”), as long as the Foundation was “then in existence and qualified ... as a charitable organization to which contributions are deductible.” *Id.* at 2. She further stated that if the Foundation “is not then in existence and so qualified, I direct the Trustee under said trust agreement to distribute the trust fund, free from trust, to such organization or organizations with comparable purposes then in existence and so qualified as the Trustee shall select.” *Id.*

The Trustee acknowledged 2006 Exercise. Counsel for the Trustee reviewed the instrument and regarded it as a valid exercise of the Second Limited Power as expanded by the Second Charitable Proviso.

Phyllis died on January 14, 2019. She had no children. Her will appointed her husband, James B. Wyeth, as the executor of her estate (the “Estate”). To avoid confusion between James Mills and James Wyeth, this decision refers to the latter as the “Executor.”

Subsequent to Phyllis’s death, her brother James thinks to inquire whether her exercise to leave the trust assets (her one-third) was valid. The court held that at common law the answer was no. Further, a statute adopted after Phyllis had died in 2019 could not expand the power. The opinion states:

The parties dispute whether Phyllis could rely on the Second Charitable Proviso to exercise the Second Limited Power for the benefit of the Foundation. As a matter of law, she could not.

Under the common law rule, the holder of a power of appointment (the “first generation” or “original” power of appointment) can use that power to create a further power of appointment (the “second generation” or “derivative” power of appointment). As a matter of law, the holder of the first generation power of appointment cannot create a second generation power of appointment that confers greater authority than the first generation power of appointment. If the first generation power of appointment is a limited power, then those limitations apply to the second generation power of appointment and to any additional derivative powers of appointment that the second generation holder or subsequent holders may create. Each power holder can create a derivative power of appointment with lesser powers by imposing additional restrictions or limitations on the derivative power, but a power holder cannot create a derivative power of appointment that expands the power beyond the grant of authority that the power holder received.[5](https://1.next.westlaw.com/Document/I0ad21810d60a11eb9f77ad1f6b0f4bfb/View/FullText.html?originationContext=docHeader&contextData=(sc.UserEnteredCitation)&transitionType=Document&needToInjectTerms=False&userEnteredCitation=2021+WL+2620585&docSource=36e3e7e976394bd3bd5f4978f0925718#co_footnote_B00052053892229)

Under the common law rule, if the settlor of a trust creates a first generation power of appointment and stated that the power only could be used to appoint the corpus of the trust in favor of a limited class of persons (the “appointees” or “objects” of the power), then the holder of that power can use it to create a second generation power of appointment in favor of any permissible appointee of the first generation power. However, the holder cannot expand the scope of the second generation power beyond the first by adding additional objects. See Foulke, 40 A.2d at 716; Simes and Smith, supra, § 977.

The same rule applies to the holder of the second generation power of appointment. The holder of that power can use it to create a third generation power of appointment in favor of any of the permissible appointees of the second generation power, but the holder cannot expand the scope of the third generation power beyond the scope of the second (or the first) by adding additional objects.

The common law rule applied in Delaware when Felix created the Original Limited Power, when Alice executed the four instruments that exercised the Original Limited Power (including the operative 1986 Exercise), and when Phyllis executed the 2006 Exercise. Under the common law rule, Phyllis could not exercise a power of appointment in favor of the Foundation. The Trust Agreement only authorized the holder of the Original Limited Power to exercise the power in favor of Alice's widower or her lawful issue. Alice could and did exercise her authority under the Original Limited Power to create the Second Limited Power, but she could not expand the class of appointees who could be objects of the Second Limited Power. When Phyllis attempted to exercise the Second Limited Power in favor of the Foundation, she exercised it in favor of an appointee that was not contemplated by the Original Limited Power. The attempted appointment therefore failed.

**1. The Trust Agreement Did Not Authorize A Power Holder To Add Appointees**

The common law rule against permitting a power holder to add appointees is a default rule. A settlor can deviate from the common law rule by including express language in the first generation power of appointment that permits the power holder to add appointees. The common law authorities framed the rule as a presumption against the power to add appointees, which the power holder could overcome by pointing to language in the instrument that supported the existence of that power. See Restatement (Third) § 19.14.

The Foundation claims that the Trust Agreement contained language sufficient to overcome the presumption, but that view rests on a motivated reading of the Trust Agreement. According to the Foundation, the Original Limited Power empowered Alice to add appointees because it provided that the trust fund would be conveyed “in such manner and amounts and upon such trusts, terms and conditions as [Alice] shall have appointed.” Pet. Ex. A § 1. The Foundation contends that this language included the power to add appointees.

In making this argument, the Foundation fails to distinguish between the object of a power, i.e. the permissible appointees, and the form of property interest that the object of a power can receive, i.e. property free from trust, in trust, or subject to other terms, conditions, and limitations. See Equitable Tr. Co. v. James, 47 A.2d 303, 306 (Del. Ch. 1946). The two concepts are distinct. The first refers to the recipient of the property. The second refers to the extent of the property interest that the recipient receives, traditionally described as the quantum of the estate. See id.; Wilmington Tr. Co. v. Wilmington Tr. Co., 180 A. 597, 602 (Del. Ch. 1935), modified on other grounds, 186 A. 903 (Del. Ch. 1936). A grantor can create a power of appointment that is general as to its objects but limited as to the quantum of estate that the holder can confer. Or a grantor can create a power of appointment that is limited as to its objects, but unlimited as to the quantum of estate that the holder can confer. See Foulke, 40 A.2d at 717.

Through the Original Limited Power, the Trust Agreement conferred on Alice a power of appointment that was limited as to its objects (her widow or lawful issue) but unlimited as to the quantum of estate that she could confer on those objects (“in such manner and amounts and upon such trusts, terms and conditions as [Alice] shall have appointed”). The language that the Foundation cites only addressed the quantum of estate. It did not address the permissible objects. The language therefore did not authorize Alice to create additional objects, as she attempted to do through the Second Charitable Proviso.

\* \* \*

Consistent with the common law rule, the 2014 version of Section 505(a) continued only to permit the holder a limited power of appointment—now termed a nongeneral power of appointment— “to appoint such assets among objects all of whom are objects of the original power.” The power holder remained unable to expand the scope of the power of appointment by adding new objects.

Effective June 19, 2019, after Phyllis died and this dispute arose, the General Assembly amended Section 505(a) again, this time to add the Appointee Expansion Statute. As a result of the amendment, Section 505(a) currently states:

Unless the instrument creating a nongeneral power of appointment expressly manifests a contrary intent of the donor, the donee of such a power, in addition to exercising the power in any other manner permitted by law and the instrument creating the power, may effectively appoint all or a portion of the assets subject to such power to a trustee or trustees for the benefit of 1 or more objects of the power and may, in addition, create in an object of the power a general or nongeneral power of appointment, exercisable during life or at death, over assets subject to the original power or may create in a person who is not an object of the power a nongeneral power of appointment, exercisable during life or at death, to appoint such assets among objects all of whom are objects of the original power.

25 Del. C. § 505(a) (2019). The Appointee Expansion Statute changed the law so that future power holders in Alice's and Phyllis's positions would be able to use a limited power of appointment to create a power of appointment “in a person who is not an object of the power.”

The enactment of the Appointee Expansion Statute does not change the result in this case. The history of Section 505 shows that in 2003, the General Assembly initially codified the common law rule, reinforcing the conclusion that when Phyllis executed the 2006 Exercise, she could not appoint her trust to an appointee outside the scope of the Original Limited Power. The attempt to appoint the Foundation as the recipient of the trust corpus was therefore invalid.

The enactment of the Appointee Expansion Statute demonstrates instead that it required a change in the law to authorize what Phyllis attempted to do. A statute was not necessary; a court ruling could have altered the common law rule. Some change in the law, however, was needed.[7](https://1.next.westlaw.com/Document/I0ad21810d60a11eb9f77ad1f6b0f4bfb/View/FullText.html?originationContext=docHeader&contextData=(sc.UserEnteredCitation)&transitionType=Document&needToInjectTerms=False&userEnteredCitation=2021+WL+2620585&docSource=36e3e7e976394bd3bd5f4978f0925718#co_footnote_B00072053892229)

## **Trust Termination Would Violate Material Purpose (Nebraska)**

. The court in In re McGregor, 308 Neb. 405 (Ne. 2021), concluded terminating a spendthrift trust would violate a material purpose.

Husband (Clifford) died, and the relevant trust was for Evelyn (wife/mother)’s benefit and then for their children. The court describes the trust as follows:

Evelyn retained all net income generated from the real estate owned by the Family Trust and paid all real estate expenses, such as real estate taxes and income taxes.

The Family Trust creates separate “carve-out” trusts for Clifford and Evelyn's two children, Allen and Debra L. Schardt (Debra). Upon Evelyn's death, the rest and residue of the Family Trust is to be equally distributed to the separate carve-out trusts, which are named the “Allen Eugene McGregor Family Trust” and the “Debra Louise Schardt Family Trust.” The Family Trust states that it is Clifford's intent, to the extent possible, to treat the children equally. If the Family Trust contains sufficient funds, the value of the distributions to the separate carve-out trusts will be equalized. However, if there are insufficient funds, the distributions will not be equalized.

Allen and Debra are to become the trustee of his or her respective trust. The trust instrument states that the assets of the carve-out trusts “shall remain in trust” and that the trusts “shall be irrevocable and shall not be revoked or amended in whole or in part by the trustee, beneficiary or any other person.” In the event of the death, resignation, or inability of a trustee of a carve-out trust, the Family Trust contains provisions to select a successor trustee, which could include a survivor of Allen and Debra, or a designated corporation or bank.

Until the death of Allen or Debra, the trustee of his or her respective trust shall from time to time, in his or her discretion, pay for the health, education, support, or maintenance of his or her children or grandchildren. In distributing trust income, the trustee must give first priority to Allen or Debra and secondary priority to Allen's or Debra's respective children. The trust instrument states that it is Clifford's intent that each carve-out trust be construed as “a non-support discretionary spendthrift trust that may not be reached by the beneficiaries[’] creditors for any reason.” Upon the death of Allen or Debra, pursuant to a limited power of appointment, the trustee of the deceased's carve-out trust may transfer the remainder of the separate trust for the benefit of a person, corporation, or other entity, but it shall not be exercised in favor of Allen or Debra, his or her estate, or creditors of his or her estate.

In May 2011, Evelyn, Allen, and Debra entered into a trust settlement agreement, which, upon Evelyn's death, provides for the distribution of the Family Trust's assets directly to Allen and Debra, free of trust. Per the agreement, Allen would receive an additional tract of real estate not distributed under the Family Trust. Further, the agreement requires an equalization payment between Allen and Debra. In May 2017, Evelyn emailed Allen, purporting to revoke the agreement.

The court concluded the agreement was unenforceable because the spendthrift provisions were a material purpose of the trust. Of course, as a practical matter, had Evelyn not wanted to rescind the agreement it would been carried out in all likelihood.

## **Conflicts of Law – Will**

. The case of In Re Estate of Marie G. Dow, 2021 WL 199619 (N.H. 2021), involves the pretermitted heirs statute of both New Hampshire and Massachusetts. The decedent died in New Hampshire but her Will provided for Massachusetts law to govern. The court recites these facts:

Marie G. Dow executed her last will and testament on June 30, 2014. At that time, she was living in Massachusetts. She passed away on November 20, 2018, having moved to an assisted living facility in New Hampshire approximately a year earlier. Just prior to her death, she sold her real property in Massachusetts, and there is no dispute that her estate consists of only personal property. In addition to her son Christopher Dow and ex-daughter-in-law Leslie Dow, Marie G. Dow is survived by another son and her granddaughter. Her will provides, in pertinent part,

[ARTICLE] SECOND: All the rest, residue and remainder of my estate, real, personal and mixed, of which I may die, seized and possess, or to which I may be entitled at the time of my demise, wheresoever the same may be found (hereinafter called my “residuary estate”), I give, devise and bequeath to my daughter-in-law, LESLIE DOW ....

If LESLIE DOW fails to survive me, then I hereby give, devise and bequeath my estate to my granddaughter ....

....

[ARTICLE] EIGHTH: I have intentionally omitted to mention, or to devise or bequeath or give anything of which I may die seized and possessed, or to which I may be in any way entitled at the time of my decease, to any person or persons other than those mentioned in this my last Will and Testament.

[ARTICLE] NINTH: My estate is to be administered and enforced according to the laws of the Commonwealth of Massachusetts.

The first issue was which state’s law applied? The court determined it would apply New Hampshire law:

We first address whether the New Hampshire probate division erred in applying Massachusetts’ pretermitted heir statute, rather than New Hampshire's RSA 551:10, to the testator's will. On appeal, the petitioner argues that, despite the language of Article Ninth in his mother's will, RSA 551:10 applies because his mother was domiciled in New Hampshire at the time of her death and her estate consists of only personal property. The respondent argues that “[t]he intent of Marie G. Dow is clear,” (bolding and capitalization omitted), pursuant to Article Ninth of her will, that Massachusetts law should apply and asserts that New Hampshire “give[s] effect” to choice-of-law provisions in wills. We agree with the petitioner.

\* \* \*

We note that our prior case law, contemplating the applicability of New Hampshire's pretermitted heir statute where the facts implicated more than one jurisdiction, has not expressly dealt with a provision like that of Article Ninth in Marie G. Dow's will, expressing her intent to have her estate “administered and enforced according to the laws” of another state — the Commonwealth of Massachusetts. See, e.g., In re Estate of Rubert, 139 N.H. at 276, 651 A.2d 937 (applying Virginia law to determine whether the plaintiff was a pretermitted heir entitled to an intestate share of the testator's personal property where the testator was domiciled in Virginia); Royce, 117 N.H. at 895, 897, 379 A.2d 1256; cf. In re Farnsworth's Estate, 109 N.H. at 15-19, 241 A.2d 204. While it is true that we attempt to give maximum effect to a testator's intent, see In the Matter of Jackson, 117 N.H. 898, 903, 379 A.2d 832 (1977), our law does not support the application here of another state's pretermitted heir statute independent of the governing law of the testator's domicile at death with respect to dispositions of personal property, see In re Estate of Rubert, 139 N.H. at 276, 651 A.2d 937; see also Restatement (Second) Conflicts of Laws, supra § 263(1), at 121. But see Royce, 117 N.H. at 896-97, 379 A.2d 1256 (creating an exception that was limited to the facts of that case).

Section 264 of the Restatement (Second) Conflicts of Laws supports a testator's ability, in bequeathing interests in personal property, to select the rules of construction of another state for use in construing the language of her will. See Restatement (Second) Conflicts of Laws, supra § 264(1), at 125 (“A will insofar as it bequeaths an interest in movables is construed in accordance with the local law of the state designated for this purpose in the will.”); id. § 264 cmt. e at 126-27 (“The forum will give effect to a provision in the will that it should be construed in accordance with the rules of construction of a particular state.”).[4](https://1.next.westlaw.com/Document/I9a1bc5b05bbd11eba7f5c3350fe353a8/View/FullText.html?transitionType=UniqueDocItem&contextData=(sc.Search)&userEnteredCitation=2021+WL+199619#co_footnote_B00042052805065) We have not expressly adopted this section of the Restatement, and we need not consider doing so here because even assuming without deciding that Article Ninth designated Massachusetts’ rules of construction for application to the will, neither Massachusetts’ nor New Hampshire's pretermitted heir statute constitutes a rule of construction. See In re Craig Living Trust, 171 N.H. 281, 284-85, 194 A.3d 967 (2018) (explaining RSA 551:10 is not a rule of construction). Compare Mass. Gen. Laws Ann. ch. 190B, § 2-302 (pretermitted heir statute), with Mass. Gen. Laws Ann. ch. 190B, §§ 2-601 to 2-610 (West 2012 & Supp. 2020) (encompassing the rules of construction applicable to wills), and Mass. Gen. Laws Ann. ch. 190B, §§ 2-701 to 2-711 (West 2012 & Supp. 2020) (encompassing the rules of construction applicable to donative dispositions in wills and other governing instruments). As will be discussed in section III, not only is RSA 551:10 not a rule of construction, it is a conclusive rule of law. See In re Craig Living Trust, 171 N.H. at 284-85, 194 A.3d 967.

We, therefore, hold that New Hampshire's pretermitted heir statute applies to Marie G. Dow's will because she was a domiciliary of New Hampshire at the time of her death and her will disposes of only personal property. Accordingly, the probate division erred in applying Massachusetts law to determine that the petitioner is not a pretermitted heir.

## **Accepting Will Benefits Precludes Will Contest**

. Suppose you might secure one-third of an estate valued a $1,427,209.94 if you won a contest to throw the Will out. The executor distributes to you $43,229.15 in specific bequests which you accept. You decide to challenge the Will arguing that what you accepted is less than what you would have received. Do you win? Well in Texas you could win at the appellate level before losing before the Texas Supreme Court, which is what happened in Estate of Johnson:

Similarly unavailing is MacNerland’s claim, accepted by the court of appeals, that she is not estopped because she did not accept all that the will entitles her to receive. A beneficiary may enforce the will according to its terms; such an action does not ask to set the will aside. Estoppel by acceptance of benefits also does not preclude the beneficiary from challenging the executor’s conduct or seeking the executor’s removal. In such instances, the beneficiary is seeking to enforce the terms of the will, not to invalidate them. Because they similarly seek enforcement, MacNerland’s analogies to cases involving contract disputes and divorce settlements are inapt. When a party receives partial payment under a contract or judgment and sues to recover more, the positions are not inconsistent; the party seeks to enforce the contract or order, not to invalidate it. In a will contest, however, the beneficiary does not seek to enforce the terms of the will; she charges that the will is invalid. A beneficiary must firmly plant herself on the side of the will’s validity or invalidity and accept the consequences of that election.

\* \* \*

MacNerland argues that an opportunistic executor could offensively deny a would-be will contestant’s claim by partially distributing the estate to an unwitting beneficiary to avoid a will contest. The doctrine sufficiently accounts for this concern, however, by requiring that a beneficiary voluntarily accept the benefit. If a beneficiary or devisee lacks knowledge of some material fact at the time of acceptance, she may take steps to reject the benefit. MacNerland did not attempt to return the mutual fund account to the estate or assert in this case that her acceptance of the account was involuntary.

## **Common-Law Same Sex Marriage May Be Based On Intent Before Same Sex Marriage Allowed**

. LaFleur v. Pyfer, 479 P.3d 869 (Colo. 2021), involves a fascinating issue. The dissent states the issue most clearly:

Is it possible for a same-sex couple in Colorado to have mutually intended and agreed to enter into a legal marital relationship when both parties were aware that Colorado law prohibited same-sex marriage at the time? The answer is clearly no. When Pyfer and LaFleur participated in their wedding ceremony in November 2003, they both understood that same-sex couples could not lawfully marry in Colorado because Colorado considered same-sex marriage unlawful, unenforceable, and invalid. Thus, Pyfer and LaFleur could not possibly have intended or agreed to enter into the legal relationship of marriage. And, because common law marriage in Colorado requires mutual intent and agreement to enter into the legal relationship of marriage, In re Marriage of Hogsett & Neale, 2021 CO 1, ¶ 49, 478 P.3d 713, 723–24, Pyfer and LaFleur cannot be deemed to have entered into a common law marriage.

Only after the Supreme Court's decision in Obergefell v. Hodges, 576 U.S. 644, 135 S.Ct. 2584, 192 L.Ed.2d 609 (2015), rendered our state's ban on same-sex marriage unconstitutional could Pyfer and LaFleur have mutually intended and agreed to enter into a common law marriage. But [Obergefell](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=2036545719&pubNum=0000780&originatingDoc=I27936d40544211eb960a9329eed1cde2&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.Default)) wasn't announced until June 2015—more than a decade after Pyfer and LaFleur had their wedding ceremony

The majority interprets the requirements of common law marriage differently, focusing on the intent to have a long-term marital relationship, rather than a specific legal relationship:

**C. Application of the Updated Common Law Marriage Framework**

Having concluded that Pyfer and LaFleur were not, as a matter of law, barred from entering into a common law marriage, we next determine whether a common law marriage was established under the refined test we announce in Hogsett. “A determination of whether a common law marriage exists turns on issues of fact and credibility, which are properly within the trial court's discretion.” Lucero, 747 P.2d at 665. Accordingly, we review the court's factual findings for clear error and its common law marriage finding for an abuse of discretion.

LaFleur argues that the parties did not, as a factual matter, have the intent to enter into a common law marriage. We disagree and conclude that the record supports the district court's conclusion that Pyfer and LaFleur manifested a mutual intent to enter into a marital relationship.

“[A] common law marriage may be established by the mutual consent or agreement of the couple to enter the legal and social institution of marriage, followed by conduct manifesting that mutual agreement.” Hogsett, ¶ 49. “In assessing whether a common law marriage has been established, courts should give weight to evidence reflecting a couple's express agreement to marry.” Id. In the absence of such evidence, courts may infer such an agreement from the parties’ conduct. Id.

As we explain in Hogsett, the factors identified in Lucero, 747 P.2d at 665, can still be relevant to this inquiry. Courts should therefore consider factors such as

cohabitation[;] reputation in the community as spouses[;] maintenance of joint banking and credit accounts[;] purchase and joint ownership of property[;] filing of joint tax returns[;] ... the use of one spouse's surname by the other or by children raised by the parties[;] ... evidence of shared financial responsibility, such as leases in both partners’ names, joint bills, or other payment records; evidence of joint estate planning, including wills, powers of attorney, beneficiary and emergency contact designations; ... symbols of commitment, such as ceremonies, anniversaries, cards, gifts, and the couple's references to or labels for one another[;] ... [and] the parties’ sincerely held beliefs regarding the institution of marriage.

Hogsett, ¶¶ 55–56. These factors must be assessed in context, however, and “the inferences to be drawn from the parties’ conduct may vary depending on the circumstances.” Id. at ¶ 49.

As in Hogsett, “[w]e begin by reviewing evidence of an express agreement to marry.” ¶ 62. Here, Pyfer proposed marriage to LaFleur, and LaFleur accepted. The parties then participated in a ceremony that, as the district court explained, “certainly appear[ed] to be a wedding.” For instance, Pyfer and LaFleur exchanged vows during the ceremony, which was officiated by a reverend and was attended by friends and family. They exchanged rings and wore tuxedos. A toast was given. And Pyfer and LaFleur signed a document titled “Certificate of Holy Union”—much like a couple would sign a marriage license. This evidence suggests, as the district court found, that the parties expressly agreed to enter into a common law marriage as of November 30, 2003, the date of the ceremony.

That said, given the range of meanings that a same-sex couple might ascribe to such a ceremony before Obergefell, it is important to examine the other circumstances of the relationship to discern the parties’ intent. Hogsett, ¶ 54 n.9. Here, the parties’ conduct was such that, in addition to the ceremony, a mutual agreement to enter into a marital relationship may be inferred. Of course, some of the evidence does not point in either direction. While it would have been significant had one of the parties used the other's surname, for example, the fact that they did not do so does not necessarily suggest that the parties did not intend to be married. See Hogsett, ¶ 45 (“[T]here may be any number of reasons, including cultural ones, that spouses and children do not take one partner's name at marriage.”). Similarly, the parties’ failure to file joint tax returns reveals little, especially given that for the majority of their relationship, this was not a possibility under federal law. See Hogsett, ¶ 66.

Other factors, by contrast, are more instructive. Although the parties did not share joint bank accounts or own property together, they cohabitated, and LaFleur financially supported Pyfer, both in his day-to-day life and in his pursuit of a career. And Pyfer listed LaFleur as his spouse on several forms over the years.

LaFleur did not tell his coworkers that he was married. But there was testimony that LaFleur worked in an environment that was not welcoming of same-sex couples; thus, viewed in context, his failure to publicize his relationship with Pyfer does not necessarily reflect a lack of mutual agreement to be married. See Hogsett, ¶ 51 (“There may be cases where, particularly for same-sex partners, a couple's choice not to broadly publicize the nature of their relationship may be explained by reasons other than their lack of mutual agreement to be married.”). Pyfer, by contrast, “held himself out as married to family and friends” with LaFleur's knowledge.

True, there was evidence, toward the end of their relationship, that Pyfer was involved in an extramarital affair and that Pyfer and LaFleur ceased sharing a bedroom and instead lived separately in the same house. However, the parties’ actions as their relationship deteriorated cannot be used to override their earlier agreement to be married. See Hogsett, ¶ 57 (“[C]onduct inconsistent with marriage that occurs as a relationship is breaking down should not negate a finding of common law marriage where there is evidence of the parties’ earlier mutual agreement to be married. In other words, infidelity, physical separation, or other conduct arising as the relationship is ending does not invalidate a couple's prior mutual agreement to enter a common law marriage.”).

In short, viewing the record as a whole and considering the totality of the circumstances, the district court's conclusion that the parties mutually agreed to be married and “intended to be joined with [each other] for the rest of [their] li[ves]” is supported by the record. Accordingly, we affirm the court's conclusion that Pyfer and LaFleur entered into a common law marriage.

A concurrence and dissent argued that the parties were married because they had a wedding and that factors were confusing and unnecessary in the analysis.

## **Non-Participants In Mediation Beware**

. Breslin v. Breslin, 62 Cal.App.5th 801 (Cal. Ct. App. (2d) 2021), reaches an important, if succinct, conclusion:

The trustee of a decedent's trust petitioned the probate court to determine the trust beneficiaries. The potential trust beneficiaries received notice of the petition. The probate court ordered the matter to mediation. The same potential beneficiaries received notice of the mediation, but some did not participate. The participating parties reached a settlement that excluded the nonparticipating parties as beneficiaries. The probate court approved the settlement. The nonparticipating parties Pacific Legal Foundation et al. (collectively “the Pacific parties”) appeal. We affirm. A party receiving notice under the circumstances here, who fails to participate in court-ordered mediation, is bound by the result.

## **Virginia Supreme Court Does Not Know What “Fair Market Value” Means**

. Jeanne Mangano executed a will and codicil allowing her son to buy certain real estate within a year of her death from his three sisters for “an amount equal to the fair market value at the time of my death.” The earlier will had tied the purchase price to the tax assessment. After exercising the option, son decided he didn’t want to buy the property but his sisters sued saying he had exercised the option so they had a contract. Son argued, and the Virginia Supreme Court agreed, that the price was too vague. The opinion states:

Here, the Option indicated that the price would be the “fair market value” on the date of Jeanne's death. The issue, which is one of first impression, is whether the term “fair market value” on a date certain is sufficient, without more specificity, to provide a mode for ascertaining the sale price with sufficient certainty so as to permit a court to compel specific performance of a contract for the sale of real estate.

\* \* \*

Reading the usual, ordinary, and popular meaning of “fair market value” into Jeanne's codicil, it appears that Jeanne gave Anthony the option to purchase the Property at a price that the Sisters are willing to accept and that Anthony is willing to pay on the open market and in an arm's-length transaction. There is no single, fixed approach to determine fair market value, as applied by appraisers or Virginia courts. To determine a property's fair market value, Virginia courts recognize many valuation approaches, such as the cost approach, income approach, sales approach, development cost analysis, and comparable sales approach. See Keswick Club, L.P., 273 Va. at 137, 639 S.E.2d 243; Fruit Growers Express Co., 216 Va. at 604, 221 S.E.2d 157. “Each of these approaches utilizes different characteristics of a property to estimate fair market value, and each analyzes different elements of the property [as] likely [to] affect the price a potential buyer would be willing to pay for the property on the open market.” Keswick Club, L.P., 273 Va. at 137, 639 S.E.2d 243.

Absent a more precise specification in Jeanne's codicil regarding the particular approach to be applied to determine the Property's fair market value as of Jeanne's death, the codicil does not provide the price of the Property, or a means of ascertaining the price with certainty, without subsequent agreement between the parties. By its very nature, what is meant by the term fair market value—what a buyer is willing to accept and what a seller is willing to pay for something on a given day—cannot be known with certainty absent a more specific means for determining it being provided in the codicil. In this instance, the language in the codicil lacks the precision required to produce a “certainty” as to price, which would allow a court to equitably compel a party to specifically perform a contract for the purchase of real property.

CONCLUSION

In summary, we find that the “fair market value” term, as set out in the codicil, does not provide a price for the Property, nor does it provide a mode for ascertaining the price with sufficient certainty.

## **Court In One State Applying The Law of Another Is Problematic**

. Sirgutz v. Sirgutz, 2021 WL 1657568 (Fl. App. (4th) 2021), dealt with an antenuptial provision that provided for a lump sum payment to the former wife. The agreement was subject to New York law, leaving the Florida court to sort out what it thought New York law is. The majority and dissent disagreed about New York law as is seen in the excerpts from the opinion:

MAJORITY

The former wife argues the trial court erred in ruling the Antenuptial Agreement's lump sum alimony obligation did not survive the former husband's death because the clear intent of the agreement was to provide her with survivorship benefits after a dissolution of their marriage. The former husband's estate responds the former husband's obligations terminated upon his passing because the Antenuptial Agreement did not explicitly provide for, nor expressed an intent for survivorship benefits following a marriage dissolution.

\* \* \*

This issue is governed by New York law because the Antenuptial Agreement was executed in New York and includes a provision mandating its interpretation under New York law. See Lamb v. Lamb, 154 So. 3d 465, 467 (Fla. 5th DCA 2015) (“Generally, Florida courts enforce contractual choice-of-law provisions unless enforcing the chosen forum's law would contravene strong Florida public policy.”).

Under New York law, it is a “well-accepted proposition that a husband's obligation to support his wife terminates with the husband's death.” Cohen v. Cronin, 39 N.Y.2d 42, 45, 382 N.Y.S.2d 724, 346 N.E.2d 524 (1976). “However, the husband might, by agreement, impose upon his estate a duty to make alimony or support payments after his death.” [Id.](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1976110990&pubNum=0000605&originatingDoc=I06f90810a86111ebbbbbabec583fa227&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) “[T]o bind the estate, a separation agreement **must either specifically provide for the continuation of payments or evince, from the terms of the agreement read as a whole, a clear intention that support payments continue**, notwithstanding the husband's death.” Id. (emphasis added).

The former wife concedes the Antenuptial Agreement does not expressly provide that the lump sum alimony provision survive the former husband's death, but argues that, taken as a whole, its provisions evince an intent to provide as such. She relies on Cohen and Matter of Riconda, 90 N.Y.2d 733, 665 N.Y.S.2d 392, 688 N.E.2d 248 (1997), in support.

In Cohen, the New York Court of Appeals concluded the husband's estate was required to make support payments under the terms of the parties’ separation agreement. 39 N.Y.2d at 47, 382 N.Y.S.2d 724, 346 N.E.2d 524. There, the agreement provided that payments would terminate where the wife remarried, or the obligation expired. Id. at 46, 382 N.Y.S.2d 724, 346 N.E.2d 524. It did not include language suggesting payments were to be made during the joint lives of the parties or terminate upon death of either party. Id. The court reasoned that “in consideration for the release of her other marital rights, the wife acquired the security of having periodic payments made for her support during her lifetime, or, at least, until a remarriage.” Id. at 46–47, 382 N.Y.S.2d 724, 346 N.E.2d 524.

Cohen is inapplicable here, however, because the Antenuptial Agreement includes other support for the former spouse.

In Riconda, the Court of Appeals of New York declined to apply Cohen. 90 N.Y.2d at 739, 665 N.Y.S.2d 392, 688 N.E.2d 248. “The judicial search is **for specific, relevant contractual intent of the parties**....” Id. (emphasis added). Because the agreement in [Riconda](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1997232759&pubNum=0000605&originatingDoc=I06f90810a86111ebbbbbabec583fa227&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)) “simply provide[d] for maintenance payments until [the wife's] death or remarriage” and was “silent as to the eventuality and consequence of his predeceasing her,” the court remanded the case to the lower court for a determination of the parties’ intent in drafting and executing their agreement. Id. at 739–40, 665 N.Y.S.2d 392, 688 N.E.2d 248.

Here, the parties’ Antenuptial Agreement provided that “the husband shall pay to the wife, for her support and maintenance, $75,000 per year (in twelve equal monthly installments) for a period of two years after the date of entry of such judgment or until the wife's earlier death or remarriage.” The Antenuptial Agreement did not speak to the effect of the former husband's death. It expressly provided the former wife had an independent source of income. Under New York law, this was sufficient to establish the presumption that the obligation did not survive the former husband's death. See id. at 738, 665 N.Y.S.2d 392, 688 N.E.2d 248 (“When the four corners of the agreement contain no unequivocal direction to pay after death, and when discernible manifestations of intent reflect that support for the recipient spouse after the death of the payor spouse is otherwise provided for, the statutory and precedential preference that maintenance obligations terminate upon the death of the payor should ordinarily prevail.”).

The Antenuptial Agreement expressly provided for the former wife's financial support in the event of the former husband's death, “if the parties are still married to each other and residing together at the time of the Husband's death.” It provided:

Notwithstanding the provisions of Article 4, [the waiver provision], **if the parties are still married to each other and residing together at the time of the [h]usband's death**, the [h]usband desires to make a fair and reasonable provision for the [w]ife in lieu of the rights that, after the Marriage, she might or could have had as a Wife or widow absent this Antenuptial Agreement. The parties therefore agree to the following:

The [h]usband shall, upon the marriage, provide in his last will and testament for a trust fund to take effect upon his death, wherein $200,000 will be placed in trust, the income from said trust to be paid to the wife until the wife's death or remarriage.

It did not include similar language in the lump sum alimony provision.

DISSENT

I dissent. Because our duty is to apply New York law, the case of Gardner v. Zammit, ––– A.D.3d ––––, 128 N.Y.S.3d 383 (2020), is most closely on point, and governs this proceeding. I would reverse the final summary judgment.

In [Gardner](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=2051478161&pubNum=0007980&originatingDoc=I06f90810a86111ebbbbbabec583fa227&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)), the parties were divorced and entered into a settlement agreement with terms that the wife would pay maintenance to the husband which would terminate only upon his death. The agreement also had a provision making it binding upon “the parties, their heirs, executors, legal representatives, administrators and assigns.” After the former wife died, her estate refused to make further payments to the former husband; he in turn sued the estate for the payments. [Id.](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=2051478161&pubNum=0007980&originatingDoc=I06f90810a86111ebbbbbabec583fa227&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation))

The court determined that the estate was liable for the maintenance payments. It reasoned:

A settlement agreement is a contract subject to principles of contract interpretation, and the court “should interpret the contract in accordance with its plain and ordinary meaning” (Matter of Wilson, 138 A.D.3d 1441, 1442 [31 N.Y.S.3d 331 (4th Dept. 2016)] [internal quotation marks omitted]). In addition, “[t]he intent to vary the statutory and precedential preference of an end to maintenance payments upon death of the payor must be expressed clearly” (Matter of Riconda, 90 N.Y.2d 733 [665 N.Y.S.2d 392, 688 N.E.2d 248]). Here, neither party contends that the settlement agreement is ambiguous. We agree with plaintiff that the clause at issue unequivocally permits the termination of the maintenance obligation on the happening of one event only: the death of plaintiff. Further, the settlement agreement makes all provisions of the agreement binding on “the parties, their heirs, executors, legal representatives, administrators and assigns.” Thus, plaintiff met his initial burden on the motion of establishing that the maintenance payments were intended to survive decedent's death and become an obligation of her estate ....

Id. at 384–85 (citations omitted).

Similarly, in this case, Article 6(iv)(g) provides that the two years of alimony payments shall terminate only upon the happening of one of two events: death of the former wife or her remarriage. Further, just as in Gardner, the contract stated that it was binding on the parties’ executors and administrators. Therefore, the alimony provision is binding on the estate. I conclude that Gardner is controlling.

That Article 7 provides for support if the parties were still married at the husband's death does not prove that the parties did not intend the limited alimony upon divorce to continue in case of the former husband's death. Moreover, I believe the majority is mistaken in its reliance on the statement in the agreement that the wife has income ($20,000 per year in 1986, the date of the agreement) as creating a presumption that alimony payments should not continue after death. While New York cases discuss an independent source of support from the paying spouse as evidence that the contract does not contemplate post-death continuation of maintenance payments, a spouse's own income is not the “independent provision” for the wife's support envisioned by the New York courts. Matter of Riconda, 90 N.Y.2d 733, 665 N.Y.S.2d 392, 688 N.E.2d 248, explains the type of independent source of support necessary to conclude that the alimony provision does not survive the payor's death:

Independent sources of support, from which an intent not to allow post-death continuance of maintenance payments may include the designation of a former spouse as irrevocable beneficiary on a life insurance policy and other distributions accruing upon the death of the payor spouse, or a lump-sum transfer in discharge of claims against the estate.

Id. at 739, 665 N.Y.S.2d 392, 688 N.E.2d 248 (citations omitted). In this case, there was no provision for the former wife in the estate, or by way of insurance, or any other distribution for her benefit.

The litigants may have been more satisfied, and certainly we who are third-party observers would have been, had a New York court been applying its own law.

## **In Terrorem Clause In An Undue Influence Situation**

. Giller v. Slosberg, 2021 WL 1624641 (Ga. App. 2021), involved undue influence claims regarding a trust and beneficiary designations. The trust contained an in terrorem clause, which the court found applicable despite the apparent validity of the claim. The opinion states:

This case does not involve a will. Rather, it concerns three documents which purported to distribute much of the assets of the father, David K. Slosberg: the David K. Slosberg Asset Protection Trust II, dated January 17, 2014 (Trust #2), a beneficiary form designating Giller and Seidner as beneficiaries of their father's IRA Account with First National Bank & Trust (“FNBT”) (the “IRA Account”), and a beneficiary form designating Giller, Seidner, and Slosberg as beneficiaries of their father's Agency Account with FNBT (the “Agency Account”), with Giller and Seidner each receiving forty percent of the assets and Slosberg receiving twenty percent. Slosberg believed that Giller and Seidner exerted undue influence over their father and caused their father to execute these three documents, drastically reducing his right to their father's assets.

Approximately one year before their father died, Slosberg filed suit against Giller and Seidner. After their father's death, Slosberg filed his third amended complaint, which is the operative pleading for this appeal. The amended complaint included a number of claims, including claims for undue influence, fraud, conversion, and trover against Giller and Seidner based on allegations that their father's actions were the result of diminished mental capacity and undue influence. The complaint sought, among other relief, the imposition of a constructive trust to the extent Giller and Seidner had absconded with assets to which Slosberg was entitled, and injunctive relief to prohibit Giller and Seidner from transferring or receiving any assets of their father, including, inter alia, Trust #2, the IRA Account, and the Agency Account until the court determined whether the execution of these document was the result of undue influence. Giller and Seidner answered and asserted counterclaims against Slosberg for defamation and tortious interference, seeking both a declaratory judgment and equitable relief.

Following a two and one-half week trial, the jury found in favor of Slosberg on his claims for undue influence as to all three documents: Trust #2, the IRA Account, and the Agency Account. The superior court entered final judgment on the jury's verdict, ruling “that the challenged documents pertaining to the Accounts are void and are hereby set aside, as are any transfers made pursuant to those documents.” The superior court further noted that the evidence produced at trial demonstrated that the total amount contained in the accounts at the time of the father's death was $2,372,000.01, and that all assets contained in these three accounts “had been distributed by FNBT, either to [Giller and Seidner] or into the registry of the Court, apart from $140,413.67 held in the IRA account as of December 31, 2018.” The superior court, therefore, imposed a constructive trust in favor of Slosberg for $1,056,482.31, which the court determined was Slosberg's one-third share of the accounts, plus prejudgment interest, post judgment interest, and costs.

\* \* \*

We first note that Giller and Seidner do not claim that the evidence was insufficient to support the jury's findings or in any way challenge the jury's findings that they wrongfully procured the three documents and their assets through the exercise of undue influence over their father. Rather, they attack the superior court's final judgment, arguing that (1) the in terrorem clause contained in Trust #2 precluded Slosberg from receiving any assets from that trust, (2) the superior court's imposition of a constructive trust in Slosberg's favor usurps the probate court's jurisdiction, and (3) the final judgment awarded damages above those to which Slosberg was entitled.[3](https://1.next.westlaw.com/Document/I6bac3c90a7ae11ebbbbbabec583fa227/View/FullText.html?transitionType=UniqueDocItem&contextData=(sc.Default)&userEnteredCitation=2021+WL+1624641#co_footnote_B00032053519396) These issues appear to raise mixed questions of fact and law. With mixed questions of fact and law, this Court accepts the trial court's findings on disputed facts and witness credibility unless clearly erroneous, but independently applies the legal principles to the facts. Garden Club of Ga. v. Shackelford, 274 Ga. 653, 655 (1), 560 S.E.2d 522 (2002); Suggs v. State, 272 Ga. 85, 88 (4), 526 S.E.2d 347 (2000).

1. Giller and Seidner assert that the superior court erred in allowing Slosberg to “enjoy the benefits he forfeited by initiating actions disallowed by the no-contest clause” in their father's trust. Specifically, they argue that the superior court's final judgment is inconsistent with the valid and enforceable in terrorem clause[4](https://1.next.westlaw.com/Document/I6bac3c90a7ae11ebbbbbabec583fa227/View/FullText.html?transitionType=UniqueDocItem&contextData=(sc.Default)&userEnteredCitation=2021+WL+1624641#co_footnote_B00042053519396) contained in Trust #2, which provides that benefits revoked under the clause become a part of the remainder of the Trust Estate. They further assert that not only was Slosberg not entitled to benefits under Trust #2 because of the in terrorem clause, but they were entitled to judgment in their favor on the undue influence claim as to the trust.[5](https://1.next.westlaw.com/Document/I6bac3c90a7ae11ebbbbbabec583fa227/View/FullText.html?transitionType=UniqueDocItem&contextData=(sc.Default)&userEnteredCitation=2021+WL+1624641#co_footnote_B00052053519396) We conclude that Slosberg forfeited any benefits under Trust #2 by violating the trust's in terrorem clause, and the superior court erred in not only awarding a constructive trust based on any benefits he would have received under the trust, but also in permitting the claim to proceed to the jury. We note that neither the IRA Account nor the Agency Account contained in terrorem clauses, and our decision in this division, therefore, is limited to Trust #2.

In terrorem enforcement in Georgia is strong:

Although Slosberg attempts to distinguish Duncan v. Rawls, 345 Ga. App. 345, 812 S.E.2d 647 (2018), that case is directly on point and leads us to the inescapable conclusion that the in terrorem clause in Trust #2 bars any claim attacking the trust, including a claim that the trust was executed as the result of undue influence. Duncan concerned “whether and under what circumstances Georgia public policy prohibits enforcement of an in terrorem, or no contest, provision of a trust.” Id. at 345, 812 S.E.2d 647. The case involved beneficiaries of a trust, allegedly in good faith and upon probable cause, challenging the legal validity of the trust based on a claim of undue influence. Id. “We conclude[d] that because the legislature, not this Court, determines Georgia public policy, the trial court did not err by enforcing the in terrorem clause against a claim of undue influence and therefore granting partial summary judgment to the trustees on that claim.” Id. Specifically, this Court held as follows:

Under Georgia law, a trust may be attacked where the trust results from undue influence. But ... in terrorem clauses protecting against such a challenge are allowed under Georgia law with only one codified limitation, that being the alternative disposition provision discussed above. The parties have not cited any other statutory limitation on such clauses, and we find none, let alone a good faith/probable cause exception to enforcement of an in terrorem clause.

Id. at 348 (1) (b), 812 S.E.2d 647 (citation omitted).

Howell v. Bates, 350 Ga. App. 708, 715 (3), 830 S.E.2d 250 (2019), where this Court affirmed the trial court's ruling that the petitioner had violated an in terrorem clause and forfeited her distribution under a trust. The trust in that case provided that

if a person contested or initiated legal proceedings either to challenge the validity of the Trust, the Will, or of any provision in either document, or to prevent any provision in either document from being carried out in accordance with its terms (whether or not in good faith and with probable cause), then all benefits provided for such person under the Trust and the Will would be revoked and annulled.

Id. at 714 (3), 830 S.E.2d 250 (punctuation and footnote omitted). This Court specifically held that by filing actions challenging the validity of a will with an in terrorem clause, including one in which the petitioner claimed the will was invalid due to alleged undue influence, the petitioner “clearly violated the plain language of the ‘no contest’ clause in the Trust.” Id. at 715 (3) (b), 830 S.E.2d 250.

While we sympathize with Slosberg, and we agree that it is poor public policy to permit individuals exerting undue influence over the creation of trusts to immunize their actions by including in terrorem clauses in the trusts, we must exercise judicial restraint because “[t]he legislature, and not the courts, is empowered by the Constitution to decide public policy, and to implement that policy by enacting laws.” Duncan, 345 Ga. App. at 350 (1) (b), 812 S.E.2d 647 (punctuation omitted). To that end, this Court repeatedly has stated that

[s]tatutes should be read according to the natural and most obvious import of the language, without resorting to subtle and forced constructions, for the purpose of either limiting or extending their operation. In reviewing a statute, we presume that the legislature enacts all statutes with knowledge of the existing laws.

Howell, 350 Ga. App. at 712 (2), 830 S.E.2d 250.

A review of OCGA § 53-12-22, which addresses in terrorem clauses in trusts, and OCGA § 53-4-68, which addresses in terrorem clauses in wills, indicates that Duncan, supra, was correctly decided. After our decision in [Duncan](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=2044074529&pubNum=0000711&originatingDoc=I6bac3c90a7ae11ebbbbbabec583fa227&refType=RP&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)), a full court opinion that included a special concurrence and two dissents, the legislature amended both OCGA §§ 53-12-22 and 53-4-68, adding three identical circumstances under which in terrorem clauses shall not be enforceable in trusts or wills. OCGA §§ 53-12-22 (c), 53-4-68 (c). The legislature did not, however, choose to add or amend the trust statute to void in terrorem clauses in trusts that are impossible, illegal, or against public policy, as they are in wills. See OCGA § 53-4-68 (a) (“Conditions in a will that are impossible, illegal, or against public policy shall be void.”). Instead, the legislature retained OCGA § 53-12-22 (a), which merely states, “[a] trust may be created for any lawful purpose.” “Because the legislature is presumed to act with full knowledge of the existing state of the law, it follows that the legislature chose not to adopt a good faith/probable cause exception to enforcement of no contest clauses in trusts.” Duncan, 345 Ga. App. at 349-350 (1) (b), 812 S.E.2d 647. Strictly construing the in terrorem clause, which we are obligated to do, Callaway, 321 Ga. App. at 353 (1), 739 S.E.2d 533, and presuming the legislature enacted and amended OCGA § 53-12-22 with knowledge of the existing laws, which we are obligated to do, Howell, 350 Ga. App. at 712 (2), 830 S.E.2d 250, we conclude that the superior court erred in failing to find that the in terrorem clause in Trust #2 resulted in Slosberg's forfeiture of benefits under Trust #2.

A dissent would have held that the trust was invalid altogether:

Under fundamental and settled law, the verdict and judgment that the trust before us was procured by undue influence entailed a determination that the grantor had been without capacity to execute it and therefore that it was void at its inception. The in terrorem clause falls along with the rest of the instrument. There is nothing to the contrary in Duncan v. Rawls, 345 Ga. App. 345, 812 S.E.2d 647 (2018). Adopting a rule to the contrary entails disapproving decisions of our Supreme Court. So I respectfully dissent.

“A person has capacity to create an inter vivos trust to the extent that such person has legal capacity to transfer title to property inter vivos. A person has capacity to create a testamentary trust to the extent that such person has legal capacity to devise or bequeath property by will.” OCGA § 53-12-23.

Here the verdict is an authoritative determination that the grantor lacked the capacity to create a trust. “For undue influence to be sufficient to invalidate a trust, it must amount to deception or force and coercion so that the grantor is deprived of free agency and the will of another is substituted for that of the grantor.” Lewis v. Van Anda, 282 Ga. 763, 766 (4), 653 S.E.2d 708 (2007) (citation and punctuation omitted). See also Mullis v. Welch, 346 Ga.App. 795, 799 (2) (b), 815 S.E.2d 282 (2018) (“[The standard required for invalidation of a trust] is the same standard required for the invalidation of a will or a deed as the result of undue influence over a testator/testatrix or grantor.”)

Wills and trusts executed by one without the legal capacity to do so are void from the inception. They are stillborn. Their terms are, and always were, entirely without effect. See JR Const./Elec. v. Ordner Const. Co., 294 Ga. App. 453, 455, 669 S.E.2d 224 (2008); cf. Smith v. Morris, Manning & Martin, 264 Ga. App. 24, 26, 589 S.E.2d 840 (2003) (physical precedent only). Including in terrorem clauses.

## **Family That’s Near Versus With, Can Make A Big Difference**

. The story of a family unraveling is told in Myers v. Myers, 955 N.W.2d 223 (Ia. App. 2020). Christina Myers wanted to leave Arizona to be nearer her children, specifically her son, Michael, and his wife, Krisanne. Their house was too small, so she gave them money to help purchase a larger one. Time passed, the relationship deteriorated, and Michael evicted his mother. Did he have to repay her contributions for the house? The court reviews more of the facts:

With the understanding that Christina would help finance the home and live with them, Michael and Krisanne began house-hunting that fall. In December, Michael and Krisanne found a three-story home in Cumming with enough space for their children and Christina. Michael shared the listing with Christina, who was still living in Arizona. The house had a walkout basement—finished with two bedrooms, a bathroom, and a kitchen—which the parties agreed Christina would occupy as her private living quarters. Christina thought the arrangement was fair because the basement constituted nearly one-third of the property's total square footage. Michael referred to the space as a “mother's suite.” Because the basement was set up as a recreation room, Christina anticipated making some renovations. She also planned to use the basement's unfinished space as a laundry room.

With that arrangement in mind, Michael and Krisanne made an offer of $490,000 on the Cumming house in January 2014. The seller requested an earnest-money deposit of $1500 at the time of the offer, which Michael paid. A day later, the seller made a counteroffer of $525,000 and requested another $3500 deposit due at acceptance. That same day, Michael accepted the deal and paid the deposit. Although the payments came from his personal bank account, he asked Christina to help pay for the deposits. Of the total $5000 earnest-money payments made by Michael, Christina contributed $4900.

Under the purchase agreement, two things had to occur before the March closing date. First, Michael and Krisanne had to obtain a mortgage by early February. Second, they had to make a down payment of around $105,000, which was twenty percent of the purchase price. As promised, Christina planned to contribute $85,000 from her business-sale proceeds toward the down payment.

Michael applied for a mortgage as the sole borrower. But because Michael was relying on Christina for financial support, he did not qualify for the mortgage on his own. The lender told Michael that Christina needed to submit gift letters memorializing her contributions. The contributions totaled $89,900, including the $900 and $4000 earnest-money payments and the anticipated $85,000 partial down payment. At the lender's request, Michael sent Christina three standardized gift letters, informing her the letters were necessary to obtain the mortgage.

\* \* \*

After moving into the Cumming house, Christina became responsible for one-third of the monthly bills. On the first of every month, Michael and Krisanne sent Christina a recurring reminder to pay around $800 to $900—the amount varying based on property taxes, utilities, and other expenses. Although Michael called the monthly payments “rent,” Christina testified she never thought of herself as a renter because she also shared the costs of the mortgage, the homeowner's association fees, and the home warranty. And she paid for major improvements in the basement, including remodeling the kitchen and repairing the bathroom. In the first few months of living there, Christina bought a new refrigerator, microwave, oven, washer, and dryer for her personal use. When asked if she would have made those improvements if she knew she had no ownership interest in the home, she testified: “[M]y expectation was that they were going to carry me out of that place in a coffin. This was my bridge into old age.” Michael agreed in his testimony that Christina's plan was to live in that home until her death—“that's how she proposed it to us.”

Despite Christina's contributions, her name did not appear in the transfer deed. The deed conveyed the property to “Michael J. Myers and Krisanne L. Myers, husband and wife, as Joint Tenants with full rights of survivorship and not as Tenants In Common.” Although Christina acknowledged she was not publicly listed as a co-owner, she believed her $85,000 down payment and her monthly mortgage payments established her one-third ownership of the home.

Tensions flared between the parties in 2017 over the living arrangement. Christina felt like her personal living space was “overrun” by Michael, Krisanne, and the children, contrary to what she had agreed to before moving in. Although the parties tried to reconcile their differences, the situation only worsened. So in April 2018, Christina and Michael began to discuss an “exit strategy.”

But that fall, rather than agreeing to an exit plan, Christina sued Michael and Krisanne to recover her contributions and “the full value of her share of their joint property, including her portion of the increased value of the joint property.” Shortly after filing the petition, Christina received an eviction notice from Michael and Krisanne. That notice gave her thirty days to vacate the property. But because Christina had nowhere to move, Michael allowed her to stay until she bought her own place in January 2019.

The court found the contributions were conditional gifts:

An enforceable contract has three elements: (1) offer, (2) acceptance, and (3) consideration. See Margeson v. Artis, 776 N.W.2d 652, 655 (Iowa 2009) (“It is fundamental that a valid contract must consist of an offer, acceptance, and consideration.”); see also Iowa Code § 537A.2 (2018) (“All contracts in writing, signed by the party to be bound or by the party's authorized agent or attorney, shall import a consideration.” (emphasis added)). “Generally, the element of consideration ensures the promise sought to be enforced was bargained for and given in exchange for a reciprocal promise or an act.” Margeson, 776 N.W.2d at 655. Although Michael and Krisanne claim the gift letters are contracts, they are unable to point to a bargained-for exchange. Because a gift, by its nature, does not contemplate a bargained-for exchange, their position contradicts itself.

\* \* \*

Here, the only element at issue is donative intent. Michael and Krisanne argue the language in the gift letters reveals Christina's intent to give them the money without condition. They claim, “Christina had the opportunity to review the gift letters with an attorney or determine that language within the gift letters was not consistent with her alleged agreement with Michael and therefore had the option not to sign the gift letters.” They also point to the email Christina sent Michael with the gift letters attached that said: “I must like you a lot to be giving you all this money!”

While granting that evidence, we find ample proof that her gift was not unconditional. To find that a written document meant something different from what the parties expressed in it requires proof by “clear, satisfactory, and convincing” evidence. Frederick, 147 N.W.2d at 484. To meet that test, “it is merely necessary that there be no serious or substantial doubt about the correctness of the conclusion drawn from it.” Raim, 339 N.W.2d at 624. Christina's evidence met that standard.

The record shows Christina was a single mother who was concerned about her health and retirement. She testified that her two motivations for moving to Iowa were to be with family and to invest her savings in a home. Christina was consistent throughout the trial that she believed she had a one-third ownership in the Cumming house because she contributed a substantial share of the down payment. She also paid one-third of the monthly mortgage bill from the closing in March 2014 (though she did not move to Iowa until 2015) until she moved out in January 2019. Although Michael insists the monthly payments were “rent,” the record reveals he had no rental agreement with his mother, and he did not claim any rental income on his 2015 to 2019 federal tax returns during the time Christina lived in the home.[13](https://1.next.westlaw.com/Document/Ie7efb7301f2511eba034d891cc25f3cc/View/FullText.html?transitionType=UniqueDocItem&contextData=(sc.UserEnteredCitation)&userEnteredCitation=955+N.W.2d+223#co_footnote_B00132052292789)

As to the gift letters, Christina acknowledged she read the relevant language before signing. But she credibly testified she was only doing Michael's bidding because the lender required the gift letters to issue him the mortgage. The district court found: “At the time Christina signed the letters, she had no expectation of repayment as she expected to remain living in the house until her death or its sale.” The court also found: “Michael agreed that he received the money on the condition that Christina would continue to live there.” Even in our de novo review, we give considerable weight to the district court's fact findings because the judge heard live testimony, and we have only the cold transcript from which to assess credibility. See In re Marriage of Woodward, 228 N.W.2d 74, 75 (Iowa 1975).

The court was not bound by the banking interpretation of the gift letters, as noted in footnote 14:

We understand that banks rely on gift letters “every day when making lending decisions.” See In re Felsner, 289 Fed. Appx. 879, 887 (6th Cir. 2008) (McKeague, J., dissenting). That reliance is not the question before us. Instead, we are constrained to considering whether the limited language of the letters signed by Michael and Christina forecloses Christina's recovery on her equitable theories. The letters stated Christina had no expectation that Michel would repay the gift amounts in the form of cash or future services. The letters did not address their expectation that Christina would live in the house as a condition of the gift.

## **Trust Protector Subject To Indirect Undue Influence**

. Where a beneficiary unduly influences the settlor of a trust, who in turn influences the trust protector, the undue influence may render ineffective the actions of the trust protector. Such was the holding of In the Matter of ABB Trust, 2021 WL 1884054 (Az. App. 2021). The facts are simple and sad:

In February 2016, Austin petitioned to divorce Kay, his wife of 57 years. He was 78 years old and in declining health. He was also romantically involved with Lindi, his caretaker. Austin's divorce from Kay was finished in December 2016. He then married Lindi.

Shortly before the divorce became final, Austin hired his estate planning attorney, Paul Deloughery of Magellan Law, to create an irrevocable trust. At the time, Austin “feared the women in his life” would exert “too much pressure on him to change his estate plan” and wanted “to free himself from the threat of exploitation and the pressures of undue influence.”

And so, on November 1, 2016, Austin transferred his assets into the ABB Trust (“Trust”), which generally directed that “[a]ll” of its provisions were to “be interpreted to accomplish [Austin's] objectives.” Austin created the Trust “with the intent that assets transferred to the trust be held for my benefit while I am living, and for the benefit of my beneficiaries after my death,” all under the Trust's “terms and conditions.” Austin “had a close relationship with his three daughters and wanted to ensure their beneficial interest in the Trust would be preserved upon his death.” As originally created, therefore, the Trust directed the Trustee, upon Austin's death, to distribute 45% of the Trust corpus to his former wife Kay, 45% to his three adult daughters (collectively, “Daughters”), and 10% to Lindi. The Daughters also would receive all “tangible personal property not disposed of by a written memorandum.”

Austin selected a professional trustee, Managed Protective Services, Inc. (“Trustee”), to manage the Trust's assets. He also designated a “Trust Protector” to “direct” and “assist” the Trustee “in achieving [Austin's] objectives” under the estate plan. See generally A.R.S. § 14-10818. Austin picked his attorney Deloughery to serve as the Trust Protector.

Authority to Amend the Trust

The Trust provided that Austin could not “alter, amend, revoke or terminate [its terms] in any way.” And yet, Austin authorized the Trust Protector to amend or modify the Trust: “Any amendment made by the Trust Protector will be binding and conclusive on all persons interested in the trust, unless the amendment is shown by clear and convincing evidence to have been made in bad faith by the Trust Protector.”

But the Trust limited the Trust Protector's powers. It explained, for instance, how the Trust Protector should interpret the Trust:

In exercising and considering whether to exercise any power granted to a Trust Protector under the agreement, the Trust Protector should make reasonable inquiry into any matter or seek any information that reasonably bear upon the Trust Protector's decision to exercise the power.

The Trust Protector may settle any disputes concerning the interpretation of any provision contained in [the Trust] that arise as a result of any perceived ambiguity. In doing so, the role of the Trust Protector is to ensure that [the Trust] is construed in a manner consistent with [Austin's] estate planning objectives.

Two Amendments and the Fallout

The Trust Protector twice amended the Trust in the first six months after its creation. In March 2017, he added an in terrorem clause that would invalidate the interest of any beneficiary who (a) “contests by a claim of undue influence” or “objects” to “any [Trust] amendments” or (b) “seeks to obtain adjudication in any court proceedings that [the Trust] or any of its provisions is void.” Petitioners do not contest the validity of this amendment.

At issue here is the second amendment (“Second Amendment”), which the Trust Protector adopted in May 2017. This amendment eliminated Kay as a beneficiary, made Lindi the sole income beneficiary of the Trust at Austin's death, and authorized the Trustee to distribute the Trust's assets to Lindi as “advisable for any purpose.” The Second Amendment also reduced the Daughters to remainder beneficiaries upon Lindi's death and added Lindi's sons from a prior marriage as remainder beneficiaries.

The evidence of undue influence was compelling as recited by the court:

Petitioners attached over 150 pages of exhibits to their Verified Petition and First Amended Verified Petition, including the Trust document, the First Amendment and the Resignation of Trust Protector.

Among the attachments were an unsigned affidavit of Trust Protector Deloughery that described Lindi's role in securing the Second Amendment, and an October 2018 email from Deloughery explaining: “I think the affidavit is generally correct. However, since you want it under oath, I would need to give some thought to the wording to ensure it is correct.” Drafted for Deloughery in the first person, the affidavit read:

Shortly before May 6, 2017, I received a communication from Lindi saying that Austin wanted changes to the Trust. At the time Lindi was living with Mr. Bates full time as [sic] considered herself his caregiver and mistress.

Lindi brought Austin to my office. Initially, Lindi did all the talking. She demand[ed] changes to the Trust that would be in her favor. Austin sat there next to her but said nothing. I later asked to interview Austin without Lindi. Privately Austin informed me that he wanted to provide for Lindi but did not want to give her an outright distribution.

Further, according to Petitioners, though Austin had appointed Managed Protective Services to serve as Trustee, Lindi in fact managed the assets of the Trust—collecting rents from tenants, demanding they pay higher rent and trying to refinance Trust assets. Even so, Lindi grew frustrated with the Trustee and scheduled a meeting with Austin and the Trustee's representatives in January 2018. The Trustee's representatives later described that meeting under oath, expressing their collective “shock[ ] at [Austin's] obvious incapacity.” The representatives explained that (1) Austin “was unable to speak at all due to a permanently emplaced tracheostomy tube; he was unable to open his eyes; he was sitting propped up in a chair; he made no hand gestures,” (2) Austin “was unable to speak or eat, and did not appear to be fully conscious,” (3) Lindi “answered all questions put to [Austin], stating that she understood him perfectly,” (4) Lindi became “visibly irritated” when told she would not receive the Trust's assets “outright” at Austin's death but would instead be an income Trust beneficiary for her lifetime, and (5) Lindi “demanded that [the Trustee] resign and stated that the terms of the Trust needed to be changed.”

Lindi then contacted the Trust Protector and again demanded he amend the Trust in her favor. This time, however, the Trust Protector resigned rather than accede to Lindi's demands.

In April 2018, Lindi filed paperwork to remove Managed Protective Services as trustee and appointed her daughter's friend as the replacement trustee, even though the friend “lack[ed] any experience or education to serve as a trustee.” Austin authorized the change with his thumbprint rather than his signature. He died five months later.

Lindi argued there was no claim she influenced the trust protector, an argument the court concluded was irrelevant:

Lindi contends that Petitioners’ claim is defective because it does not allege she exercised undue influence directly over the Trust Protector. But, as explained above, that argument is not supported by the statute's plain language, and this court ordinarily resists reading words or requirements into a statute. Cf. Midtown Med. Group, Inc. v. State Farm Mut. Auto. Ins. Co., 220 Ariz. 341, 347, ¶ 22, 206 P.3d 790, 796 (App. 2008) (courts do not “seek to create conflicting provisions with the result that the judiciary adds elements the legislature could have easily required but did not”).

Moreover, Lindi's argument overlooks the Trust's terms, the relationship between settlor and trust protector and the likelihood of real-world misconduct. To be sure, the Trust gave the Trust Protector the sole power to amend the Trust. But it also directed the Trust Protector to look to Austin's preferences and desires in managing the Trust.

The Trust specifically required the Trust Protector to “assist in achieving [Austin's] objectives” and mandated that “the role of the Trust Protector is to ensure that [the Trust] is construed in a manner consistent with [Austin's] estate planning objectives.” Therefore, even though the Trust Protector had final authority to approve or reject an amendment, Austin's input remained relevant, if not dispositive, under the Trust's terms. To that end, one commentator has described the role of a trust protector as “an agent [who has] been chosen by the settlor to have some level of power to guide the trustee's actions.” Philip J. Ruce, The Trustee and the Trust Protector: A Question of Fiduciary Power, 59 Drake L. Rev. 67, 68 (2010).

Further, the Trust's express “Limitation[s] on Trust Protector Powers” required the Trust Protector to conduct a reasonable inquiry before exercising his powers and to gather all information that reasonably bore on the decision to exercise his power. If Lindi exercised undue influence over Austin in a way that limited or tainted the Trust Protector's inquiry, which caused the Trust Protector to adopt her proposed Second Amendment, she accomplished precisely what § 14-10406 prohibits—exercising undue influence to induce the creation of the amendment. If Lindi is immune from an undue influence claim here, then any defendant may avoid liability under the Arizona Trust Code by simply pressuring, threatening and exploiting a vulnerable person to do their dirty work. At minimum, Petitioners should have been allowed to conduct discovery into why the Trust Protector decided to approve the Second Amendment.

A dissent would have gone the other way and held that the undue influence must have been directly of the trust protector.

## **Co-Trustee May Not Later Challenge A Decanting In Equity**

. In the Matter of: The Niki and Darren Irrevocable Trust, 2020 WL 8421676 (Del. Ch. unreported), dealt with a decanting by co-trustees, consented to by the beneficiaries. Approximately five years later the co-trustees asked the Delaware Chancery Court to determine the decanting was invalid. The opinion states:

This case was briefed around one central issue: whether the assets of the Original Trust were validly decanted into the Second Trust. Both trusts were settled by the same person, Ildiko, who is also a beneficiary of both trusts, and who was the initial sole trustee of the Original Trust. Ildiko—with Petitioner Comerica, who is a trustee of both the Original Trust and the Second Trust—now, four years later, seeks to have the purported decanting declared void as noncompliant with the Decanting Statute—a decanting that Ildiko and Comerica executed themselves, as the trustees of the Original Trust. In effect, Ildiko is asking this Court to declare void an action that she took over six years ago, an action which now appears to be to her detriment and to another beneficiary's benefit, in what I may categorize as an attack of late-onset settlor's remorse.

To be clear, as the settlor and creator of the Second Trust, Ildiko, for reasons of her own, determined to create a trust that had certain benefits for Darren, compared with the Original Trust. It also purported to benefit Ildiko herself: the Second Trust, unlike the Original Trust, allows the trustee to invade the principal on Ildiko's behalf. As the trustee of the Original Trust, Ildiko decided to place its corpus into that Second Trust. Ildiko then enjoyed the benefits of being a beneficiary of the Second Trust, including, presumably, distributions from the Second Trust, for several years. Only when conditions made her regret her prior decanting decision did she and Comerica decide to attack the legitimacy of their own actions in funding the Second Trust. To invoke equity as a remedy for those actions is, I find, itself offensive to equity. Having previously acted in a fiduciary capacity to settle and fund a trust through what she now asserts were illegal means, Ildiko cannot invoke equity for relief from that action, in her own self-interest—relief, I note, that would be to the detriment of Darren, toward whom she owes fiduciary duties. In other words, Ildiko cannot rely on past unlawful conduct as a fiduciary as the key that turns the lock to release her from the results of such conduct.

It is worth noting, I think, that unclean hands is not available where the result of applying the doctrine would itself be inequitable. So, in Portnoy v. Cryo-Cell, then-Vice Chancellor Strine refused to apply the doctrine where it would affect innocent equity-holders. The analog to those equity-holders here, perhaps, is Niki. Nothing, I note, prevents Niki from pursuing Ildiko or Comerica for breach of trust with respect to the decanting of the Original Trust, if she finds it appropriate to do so. Further, there is no allegation that this Court's application of unclean hands will work an inequity because of some wrongful action on Darren's part—no such action is alleged.

I have principally discussed unclean hands with respect to Ildiko. The fact that her co-trustee, Comerica, is sponsoring the Verified Petition does not impede me from applying the doctrine here. Comerica was a co-trustee of the Original Trust and thus had a duty to ensure that the assets were not decanted from the Original Trust in violation of the Decanting Statute. Having failed in that duty, it cannot now, four years later, invoke equity to correct its mistake in such a way that would benefit one of its beneficiaries to the detriment of another, in light of the benefiting beneficiary's actions discussed above. Accordingly, the doctrine of unclean hands bars me from hearing the merits of the Verified Petition and the Petitioner's Motion for Judgment on the Pleadings is denied.

The trustee - beneficiaries referred to as childlike - was apparently upset because the decanting created a new trust that reduced her interest, in favor of her son-in-law, if her daughter and son-in-law divorced, which they did.

## **Attorney-Client Privilege After Client’s Death**

. The facts in In re Estate of Rabin, 474 P.3d 1211 (Colo. 2020), were simple. Husband died leaving all to his widow. Former wife then appeared making a claim on two promissory notes executed while the decedent was married to his eventual widow. The widow was also the personal representative. The court notes what happened next:

Wanting more information, Claudine [widow] asked Louis's longtime attorney, Mark Freirich, for all of Louis's legal files, most of which had nothing to do with the notes. He refused, citing confidentiality concerns. She then subpoenaed the files, placing two time-honored legal principles on a collision course: client-lawyer confidentiality (given practical effect by the attorney-client privilege and Colorado Rule of Professional Conduct 1.6) and a personal representative's duty to settle a decedent's estate.

We hold that (1) Colorado's Probate Code doesn't grant a personal representative a general right to take possession of all of a decedent's legal files as “property” of the estate; (2) a decedent's lawyer is ordinarily prohibited from disclosing a decedent's legal files, even to the personal representative; but (3) a decedent's lawyer may provide the personal representative with otherwise privileged or confidential documents if such disclosure is necessary to settle the decedent's estate.

\* \* \*

Freirich moved to quash the subpoena, arguing that producing Louis's full set of files (which, according to Freirich, encompasses about forty-five individual files) would cause undue burden and expense and the “attorney-client privilege has not been waived.” Fischer then contacted Freirich, clarifying that he was “seeking the paperwork in [Freirich's] files that may have been generated around [the date of the notes] to understand the consideration” for them.

Freirich eventually provided the documents he had regarding the promissory notes, which included copies of the notes and two pages of Freirich's handwritten notes. He did so after concluding that Suyue's [former wife] presence during his discussions with Louis had vitiated any privilege that would otherwise exist.

Still, Claudine sought production of the rest of the files. Freirich responded that he didn't have “any additional information regarding the underlying debt reflected in the Promissory Note[s]”; his duty of confidentiality under Colorado Rule of Professional Conduct 1.6 prevented him from revealing more; and his refusal to comply with the subpoena was “consistent with what [he] believe[d] to be [Louis's] wishes.” Claudine countered that Freirich had to produce the files because they were Louis's property, and section 15-12-709, C.R.S. (2020), grants a personal representative the right to take possession of a decedent's property; Louis waived his attorney-client privilege by nominating her as his personal representative, and the privilege now belongs to Louis's estate; and Freirich's duty of confidentiality didn't otherwise prevent remittance of Louis's files to her, since Louis also waived his right to confidentiality by nominating her as the personal representative.

Are client files “property” of an estate? The court held they are not:

Although Rule 1.16(d) required Freirich to provide Louis with “papers and property to which the client is entitled” upon termination of the attorney-client relationship, that duty is grounded in ethics, not property law. Corrigan v. Armstrong, Teasdale, Schlafly, Davis & Dicus, 824 S.W.2d 92, 97 (Mo. Ct. App. 1992) (“ ‘Surrendering papers and property to which the client is entitled’ is one example of a step an attorney must take to protect [a former client's] interest. But, this duty ... need not be supported or justified by any property concepts.” (quoting Mo. Sup. Ct. R. 4-1.16)); Colo. Bar Ass'n Ethics Comm., Formal Op. 104, at 2 (revised Sept. 2018) (“[A] client's entitlement [under Rule 1.16(d)] is not completely defined by traditional concepts of property and ownership. Rather, the entitlement is based on the client's right to access the file related to the representation so as to enable continued protection of the client's interests.”). Moreover, Rule 1.16(d)’s reference to “papers and property” suggests that a client's property is distinguishable from “[a] client's files ... relating to a matter that the lawyer would usually maintain in the ordinary course of practice.” Colo. RPC 1.16A cmt. 1 (“A lawyer's obligations with respect to client ‘property’ are distinct [from obligations with respect to a client's files].”).

In keeping with the Colorado Rules of Professional Conduct's distinction between a lawyer's papers and a client's property, we conclude that a personal representative does not acquire a right to take possession of a decedent's legal files under section 15-12-709 except for “documents having intrinsic value or directly affecting valuable rights, such as securities, negotiable instruments, deeds, and wills.” Colo. RPC 1.16A cmt. 1. Those items are the client's property. See Restatement (Third) of the Law Governing Lawyers § 46 cmt. a (Am. Law Inst. 2000) (differentiating between client files and “writings that qualify as property ... because of their value, for example cash, negotiable instruments, stock certificates and other writings constituting presumptive proof of title, and collectors’ items such as literary manuscripts”). For the purposes of [section 15-12-709](https://1.next.westlaw.com/Link/Document/FullText?findType=L&pubNum=1000517&cite=COSTS15-12-709&originatingDoc=I13cec2a01d3d11ebaf4a97db80ef4b04&refType=LQ&originationContext=document&transitionType=DocumentItem&contextData=(sc.UserEnteredCitation)), the rest of the files are the lawyer's property.

Further, the personal representative does not take possession or control of some intangible right to access the deceased client's files. Rule 1.16(d) requires lawyers to surrender certain papers to the client when the representation ends, but that responsibility is an ethical duty owed to the client, not something the client legally owns. See Own, Black's Law Dictionary (11th ed. 2019) (“[T]o have legal title to.”). Thus, a lawyer's ethical duty to surrender papers to former clients does not pass to the personal representative under the Probate Code's definition of “property.” See § 15-10-201(42) (“ ‘Property’ means both real and personal property or any interest therein and anything that may be the subject of ownership.”).

However, the court also concludes that a testator impliedly waives the attorney-client privilege by appointing a personal representative, at least in part:

We analyze the possibility of implied waiver in light of the role of the personal representative under Colorado law. A personal representative undertakes certain statutory duties with respect to estate administration. E.g., § 15-12-703(1), C.R.S. (2020) (“A personal representative has a duty to settle and distribute the estate of the decedent ....”); § 15-12-703(4) (“[A] personal representative ... has the same standing to sue and be sued in the courts of this state and the courts of any other jurisdiction as his decedent had immediately prior to death.”). A decedent nominates a personal representative precisely because the decedent wants that individual to administer the decedent's estate.

To effectively carry out those duties (as well as any other duties specified in the will), a personal representative may need access to material otherwise protected by the attorney-client privilege. Thus, by nominating a personal representative, a client impliedly waives any claim of attorney-client privilege with respect to communications necessary for estate administration, unless the client expressly manifested the intent to maintain the privilege. See Wesp, 33 P.3d at 198 (“To prove an implied waiver, there must be evidence showing that the privilege holder, ‘by words or conduct, has impliedly forsaken his claim of confidentiality with respect to the communication in question.’ ” (quoting Miller v. Dist. Ct., 737 P.2d 834, 838 (Colo. 1987))). A decedent's former attorney may therefore provide a personal representative with privileged information necessary for the personal representative to settle the estate.[8](https://1.next.westlaw.com/Document/I13cec2a01d3d11ebaf4a97db80ef4b04/View/FullText.html?transitionType=UniqueDocItem&contextData=(sc.UserEnteredCitation)&userEnteredCitation=474+P.3d+1211#co_footnote_B00082052272283)

Accordingly, the division erred in concluding that Claudine, as the personal representative, became the attorney-client-privilege holder after Louis's death. But Louis did impliedly waive the privilege with respect to communications necessary to administer his estate by appointing her as his personal representative. The attorney-client privilege couldn't shield any otherwise privileged communications necessary to settle Suyue's claim, although we recognize that Freirich already provided Claudine with the file regarding the promissory notes.

\* \* \*

“[A] lawyer is impliedly authorized to make disclosures about a client when appropriate in carrying out the representation.” Colo. RPC 1.6 cmt. 5. Therefore, release is appropriate if “the attorney has reasonable grounds for concluding that release of the information is impliedly authorized in furthering the former client's interests in settling [the] estate.” D.C. Bar, Ethics Op. 324, at 2 (2004). So a decedent's former attorney may provide the personal representative with confidential information necessary to settle the estate unless the decedent has expressly indicated otherwise. But the attorney cannot provide a decedent's complete legal files to the personal representative unless the decedent gave informed consent for such broad disclosure in the will or elsewhere.

To hold otherwise would drastically undermine a lawyer's duty of confidentiality to a deceased client. It would grant the personal representative authority to request, from every one of a decedent's former attorneys, the decedent's entire legal history, regardless of subject matter and the needs of the estate.

There is no evidence that all of Louis's legal files were necessary to administer the estate. Thus, Freirich had a professional duty of confidentiality under Rule 1.6 to withhold all unnecessary information related to his representation of Louis. And when Claudine subpoenaed files that she did not need for estate administration, the duty of confidentiality obligated Freirich to make all non-frivolous objections (including the assertion of attorney-client privilege for any confidential communications made for the purpose of obtaining legal advice).

## **Restriction on Sale of Land Not Allowed in Iowa**

. At issue in Estate of Cawiezell v. Coronelli, 958 N.W.2d 842 (Iowa 2021), was the language in this bequest of a farm:

Vera Cawiezell died testate in April 2018, and her will was admitted to probate later that month. In item 3 of her will, Cawiezell devised approximately 150 acres of farmland to her friends Tom and Beth Coronelli subject to certain general restrictions and subject to other provisions in favor of Terry Brooks, who leased and farmed Cawiezell's land while Cawiezell was alive. Item 3 provided:

I hereby will, devise and bequeath all of my farm real estate located ... in Muscatine County, Iowa, except my homestead referred to in Item 2 above, consisting of approximately 150 acres to my friends, Tom and Beth Coronelli or unto the survivor of them, subject to the restriction that they should not sell or transfer the property outside their immediate family within a period of twenty years after my death. Terry Brooks has been leasing the farm from me under a share crop agreement and I would request that the Coronelli family continue leasing to Terry under favorable terms for his benefit. I further give Terry Brooks the first option to purchase the farm during the twenty year period following my death and I would further request that the terms of sale be favorable for Terry Brooks.

Item 4 of the will devised all farm equipment and livestock to Brooks and forgave any money Brooks owed to Cawiezell. The residue and remainder of the property was awarded to Cawiezell's friend Phyllis Knoche.

The executors proposed to implement the bequest with a deed restriction which would have read as follows:

THIS DEED IS EXECUTED AND DELIVERED UPON THE CONDITION THAT IN THE EVENT ALL OR PART OF THE HEREIN DESCRIBED PROPERTY IS SOLD OR TRANSFERRED TO ANYONE OTHER THAN TERRY BROOKS OR AN IMMEDIATE FAMILY MEMBER OF TOM AND BETH CORONELLI ON OR BEFORE APRIL 17, 2038, THEN THE HEREIN DESCRIBED PROPERTY SHALL REVERT TO PHYLLIS A. KNOCHE, OR HER HEIRS OR ASSIGNS, AS THE RESIDUAL BENEFICIARY OF THE VERA CAWIEZELL ESTATE, FREE AND CLEAR OF ANY CLAIMS OF THE GRANTEE, CONSISTENT WITH THE TERMS OF THE LAST WILL AND TESTAMENT OF VERA CAWIEZELL FILED IN MUSCATINE COUNTY IOWA, ESPR011653.

Iowa has a long-standing rule against restraints on alienation. The executors argued that the bequest was never a fee and thus wasn’t subject to the rule, an argument the court rejected because, the court held, it was circular:

The executors contend this long-standing rule is inapplicable here because the Coronellis were not bequeathed an absolute fee. Instead, according to the executors, the Coronellis were bequeathed only a limited fee that did not include the right for the Coronellis to sell or transfer the property outside their immediate family for twenty years. Because the right to sell or transfer outside the family for a period of twenty years was not included in the “bundle of sticks” devised to the Coronellis, according to the executors, the restriction does not restrain the Coronellis’ right to alienate the property.

The executors’ circular argument is unconvincing. “The purpose of construing a will is to ascertain the intent of the testator. Authorities agree that questioned provisions should be considered, not as standing alone, but as related to all other provisions of the will.” In re Est. of Organ, 240 Iowa 797, 800, 38 N.W.2d 100, 102 (1949). Here, the testamentary provision devises and bequeaths all of Cawiezell's farmland in Muscatine County, except her homestead, to the Coronellis. There is no indication in this provision or any other provision that the fee is anything other than a fee simple. See, e.g., In re Est. of Bigham, 227 Iowa 1023, 1026, 290 N.W. 11, 12 (1940) (holding that testamentary provision bequeathing property to wife was “an unqualified fee estate”); In re Est. of Hellman, 221 Iowa 552, 555, 266 N.W. 36, 38 (1936) (“The old familiar stock phrases of the common law, such as ‘in fee simple,’ ‘absolutely,’ ‘to have and to hold forever,’ do not appear, but words of this character are unnecessary in conveying the fee-simple title.”). The will's subsequent restriction on the fee is an invalid restraint on alienation under our precedents and is void. See Crecelius, 255 Iowa at 1254, 125 N.W.2d at 789; Graham, 243 Iowa at 117, 49 N.W.2d at 543; Guenther, 238 Iowa at 1351, 29 N.W.2d at 223; Sisters of Mercy, 223 Iowa at 1059, 274 N.W. at 92; McCleary, 54 Iowa at 314–18, 6 N.W. at 572–74.

The court also rejected the reasonableness standard for restraints set forth in the Restatement (Third) of Property: Servitudes §§ 3.4, 3.5, preferring a bright-line standard:

We long ago rejected case-by-case balancing in favor of a bright-line rule:

We are entirely satisfied there has never been a time since the statute quia emptores when a restriction in a conveyance of a vested estate in fee simple, in possession or remainder, against selling for a particular period of time, was valid by the common law, and we think it would be unwise and injurious to admit into the law the principle contended for by the defendants’ counsel, that such restrictions should be held valid, if imposed only for a reasonable time.

It is safe to say that every estate, depending upon such a question, would, by the very fact of such a question existing, lose a large share of its market value. Who can say whether the time is reasonable, until the question has been settled in the court of last resort? And upon what standard of certainty can the court decide it? Or, depending, as it must, upon all the peculiar facts and circumstances of each particular case, is the question to be submitted to a jury? The only safe rule of decision is to hold, as I understand the common law for ages to have been, that a condition or restriction, which would suspend all power of alienation for a single day, is inconsistent with the estate granted, unreasonable and void.

McCleary, 54 Iowa at 315, 6 N.W. at 572–73 (quoting Mandlebaum v. McDonell, 29 Mich. 78, 107 (1874)). We see no reason to abandon our long-standing rule in favor of the proposed Restatement rule. See Kersten Co. v. Dep't of Soc. Servs., 207 N.W.2d 117, 121 (Iowa 1973) (en banc) (“Stare decisis is a valuable legal doctrine which lends stability to the law ....”). Our rule is clear-cut, stable, and easy-to-apply. See McCleary, 54 Iowa at 315, 6 N.W. at 572–73 (quoting Mandlebaum, 29 Mich. at 107). These are virtues in the area of real property where certainty of title is of paramount importance.

We hold the testamentary provision restricting the beneficiaries from selling or transferring the devised property outside their immediate family for a period of twenty years following the testator's death is a prohibited restraint on alienation and is void. For these reasons, we affirm the decision of the court of appeals and the judgment of the district court.

The Iowa court arguably misconstrued the restriction as a total restraint on alienation whereas it would have allowed a transfer to family.

## **Place of Celebration Controls Existence of Marriage**

. Estate of Grossman v. Commissioner, T.C. Memo. 2021-65, involved fascinating facts. Semone Grossman married in New York in 1955. In 1965 he obtained a “unilateral divorce” in Mexico and in 1967 he married again, in New Jersey. In 1974 his relationship with his second wife was over, and his first wife sued saying she was still married to Mr. Grossman because they had never divorced. She won. In 1986, Mr. Grossman obtained a Jewish religious divorce in New York and married in 1987 his third wife in Israel. The court summarized the next 27 years as follows:

After their marriage in Israel, H and W3 returned to N.Y. and lived there as husband and wife for 27 years, until H's death in 2014. They had two children, filed joint Federal income tax returns, and shared a home and finances. During this time, W1 also lived in N.Y., saw H and W3 socially, and never challenged their marriage. W1 filed Federal income tax returns as single and made no statutory claim against H's estate after his death.

When H died in 2014, he left the bulk of his estate to W3, and the estate claimed a corresponding marital deduction under I.R.C. sec. 2056(a). R denied the deduction and argues in a motion for partial summary judgment that H's religious divorce from W1 was invalid under N.Y. law. Relying on N.Y. law, R argues that W1, rather than W3, was H's surviving spouse when he died.

So, the question could be was Mr. Grossman properly divorced from his first wife, Hilda, on the theory that without such divorce he couldn’t have married his third wife. However, that is not how the Tax Court approached the case at all:

First, the Commissioner begins his analysis by asking whether Semone and Hilda were validly divorced and relies exclusively on New York law to determine the answer. But that is the wrong starting question, and the Commissioner looks to the wrong jurisdiction for the governing law. Under section 2056(a)--the provision at issue in this case--the Court must determine whether Ziona was Semone's “surviving spouse” for Federal estate tax purposes. Accordingly, the proper starting question is whether Semone and Ziona were validly married. To answer that question, given the parties’ positions on this score, we assume (without deciding) that we should look to New York law. And New York law in turn requires us to consider the rules of the place of the celebration of the marriage, here Israel.

It is well established that capacity to marry is a prerequisite for marriage and that the prerequisites for marriage are also determined by the place of celebration. As the New York Court of Appeals in Van Voorhis, 86 N.Y. at 25 (quoting Connelly, 2 Eng. L. & Eq. 570), put it: “We all know \* \* \* that in questions of marriage contract, the lex loci contractus [the law of the place of the contract] is that which is to determine the status of the parties.” This includes whether a person seeking to remarry has been validly divorced. The Restatement (Second) of Conflict of Laws, on which the Commissioner relies, highlights the same point. Restatement, Conflict of Laws 2d, sec. 283 cmt. h (1971) (“[A] marriage will usually be valid everywhere if it complies with the requirements of the state where  it was contracted as to such matters as \* \* \* the capacity of either party to marry[.]”). Caselaw and other Federal agencies agree on this principle. See, e.g., Jahed v. Acri, 468 F.3d 230, 235 (4th Cir. 2006) (“Ordinarily, in the immigration context, the validity of a prior divorce is addressed to determine whether a subsequent marriage is lawful. See, e.g., Matter of Hosseinian, 19 I. & N. Dec. 453 (BIA 1987). In such situations, the \* \* \* [Board of Immigration Appeals] ‘look[s] to the law of the state where the subsequent marriage was celebrated to determine whether or not that state would recognize the validity of the divorce.’ Id. at 455.”).

Here, there is no dispute that Israel--the place of Ziona's marriage celebration--viewed Semone and Hilda as validly divorced and Semone as capable of remarrying. This was demonstrated by Israel's acceptance of the letter from the Beth Din of America, the issuance of a ketubah to Semone and Ziona, and the later issuance of a marriage certificate. Under Israeli law, religious divorces (i.e., gets) are fully recognized. Indeed, they are the only way for people of Jewish faith who have been married before to make themselves eligible to remarry another Jewish person in Israel. See supra Part II. Since New York law requires us to look to the law of the place of the marriage celebration to determine the parties’ capacity to marry, New York law also requires us to defer to the place of celebration and its determination on whether one of those parties was validly divorced and therefore capable to remarry. See, e.g., Matter of May, 305 N.Y. at 491, 114 N.E.2d 4. Applying this standard, we would expect the New York Court of Appeals to accept Israel's determination that Semone and Hilda's marriage had ended, leaving Semone free to marry Ziona.

In short, Israel accepted the religious divorce, Israel allowed the happy couple to marry, and New York law holds that if you are married somewhere else you are married in New York (with narrow exceptions):

More generally, the Commissioner fails to recognize that the public policy exception to the place of celebration rule is narrow. The New York Court of Appeals has held that the exception applies when a marriage falls “within the inhibitions of natural law” because it is “offensive to the public sense of morality to a degree regarded generally with abhorrence.” See Matter of May, 305 N.Y. at 493, 114 N.E.2d 4. We cannot agree that Semone and Ziona's marriage falls under this standard. This is not a case in which one spouse sought to cohabit with two or more other “spouses” at the same time. Semone was a serial monogamist who sought to end his marriage to Hilda before his marriage to Ziona began. All the parties most intimately involved in both marriages appear to have understood that Semone and Hilda were divorced and that Semone and Ziona were married.

Despite the Commissioner's efforts to show otherwise, we do not see how New York's policy interest in preventing marriages involving incest, polygamy, and the like would be implicated here.

## **Power to Appoint to Charity Does Not Create Countable Assets for Medicaid Purposes**

. At issue in Fournier v. Secretary of Executive Office of Health and Human Services, 170 N.E.3d 1159- (Ma. 2021) was whether assets in a self-settled trust where the only reservation of rights by the settlor was the power to appoint to charity – a charity over which the settlor has no control – would be countable assets for Medicaid purposes. The Massachusetts Supreme Court held that the they are not. The opinion states:

1. Four years ago, in Daley v. Secretary of the Exec. Office of Health & Human Servs., 477 Mass. 188, 203, 74 N.E.3d 1269 (2017), we raised -- but did not answer – the question whether a trust settlor's reservation of a limited power of appointment to appoint trust principal to a nonprofit or charitable entity over which the settlor has no control, contained within an irrevocable trust established by the settlor, could render the assets held in the trust “countable” for purposes of determining the settlor-applicant's eligibility for Medicaid long-term care benefits. Specifically, we instructed MassHealth to consider, in the first instance, whether there were “any circumstances,” see 42 U.S.C. § 1396p(d)(3)(B)(i), in which the settlor-applicant could use his limited power of appointment to appoint the trust principal to a nonprofit or charitable nursing home for the purpose of paying for his care. Daley, supra.

This case picks up where Daley left off. While both were living, the plaintiff, Emily Misiaszek, and her husband created an irrevocable trust, the corpus of which includes their home. The terms of the trust grant Misiaszek, during her lifetime, a limited power of appointment to appoint all or any portion of the trust principal to a nonprofit or charitable organization over which she has no controlling interest. After Misiaszek applied for and was denied MassHealth long-term care benefits, the Massachusetts Office of Medicaid's board of hearings (board) affirmed MassHealth's determination that the home was a countable asset, concluding that Misiaszek ostensibly could use her limited power of appointment to appoint portions of the home's equity, included as part of the trust principal, to the nonprofit nursing home where she resided as payment for her care. Misiaszek then sought judicial review of the board's decision, and a Superior Court judge reversed the board's ineligibility determination.

2 We conclude that under the terms of her trust, Misiaszek's limited power of appointment does not allow her, in any circumstance, to appoint the trust principal for her benefit, and thus the trust principal is not “countable” for purposes of determining her eligibility for MassHealth benefits. Accordingly, we affirm the judgment of the Superior Court and remand the case for further proceedings consistent with this opinion.

## **Ethics of Lawyer Responding to On-Line Criticism**

. In Formal Opinion 496 (January 13, 2021) the ABA addressed what lawyers should do when responding to on-line criticism. The Opinion sets forth these best practices:

A lawyer may request that the host of the website or search engine remove the post. This may be particularly effective if the post was made by someone other than a client. If the post was made by someone pretending to be a client, but who is not, the lawyer may inform the host of the website or search engine of that fact. In making a request to remove the post, unless the client consents to disclosure, the lawyer may not disclose any information that relates to a client’s representation or that could reasonably lead to the discovery of confidential information by another,8 but may state that the post is not accurate or that the lawyer has not represented the poster if that is the case.

Lawyers should give serious consideration to not responding to negative online reviews in all situations.9 Any response frequently will engender further responses from the original poster. Frequently, the more activity any individual post receives, the higher the post appears in search results online. As a practical matter, no response may cause the post to move down in search result rankings and eventually disappear into the ether. Further exchanges between the lawyer and the original poster could have the opposite effect.

Lawyers may respond with a request to take the conversation offline and to attempt to satisfy the person, if applicable. For example, a lawyer might post in response to a former client (or individual posting on behalf of a former client), “Please contact me by telephone so that we can discuss your concerns.” A lawyer whose unhappy former client accepts such a request may offer to refund or reduce the lawyer’s fees in the matter. As a practical matter, this approach is not effective unless the lawyer has the intent and ability to try to satisfy the person’s concerns. A lawyer who makes such a post but does nothing to attempt to assuage the person’s concerns risks additional negative posts.

If the poster is not a client or former client, the lawyer may respond simply by stating that the person posting is not a client or former client, as the lawyer owes no ethical duties to the person posting in that circumstance. However, a lawyer must use caution in responding to posts from nonclients. If the negative commentary is by a former opposing party or opposing counsel, or a former client’s friend or family member, and relates to an actual representation, the lawyer may not disclose any information relating to the client or former client’s representation without the client or former client’s informed consent. Even a general disclaimer that the events are not accurately portrayed may reveal that the lawyer was involved in the events mentioned, which could disclose confidential client information. The lawyer is free to seek informed consent of the client or former client to respond, particularly where responding might be in the client or former client’s best interests. In doing so, it would be prudent to discuss the proposed content of the response with the client or former client.

If the criticism is by a client or former client, the lawyer may, but is not required to, respond directly to the client or former client. The lawyer may wish to consult with counsel before responding. The lawyer may not respond online, however.

An additional permissible response, including to a negative post by a client or former client, would be to acknowledge that the lawyer’s professional obligations do not permit the lawyer to respond. A sample response is: “Professional obligations do not allow me to respond as I would wish.” The above examples do not attempt to provide every possible response that a lawyer would be permitted to make, but instead provide a framework of analysis that may be of assistance to lawyers faced with this issue.

## **Amount of Wrongful Death Proceeds Included in An Estate**

. In Morley v. Director, Division of Taxation, 32 N.J.Tax 366 (NJ Tax Court 2021), the decedent died in 2014 when utility workers created a natural gas explosion in front of the decedent’s house. In 2017 the case settled for $20,000,000, which became $13,418,462.15 after counsel fees and expenses. That amount was divided, per New Jersey law, half to the survivors and half to the estate. So the estate received $6,709,231.08. An appraiser had valued the estate’s claim at $2,690,600. The parties agreed that the wrongful death claim proceeds paid to the survivors were not subject to New Jersey estate tax, leaving the determination of value of the estate claim. The opinion states:

Here, the transfer inheritance tax laws dictate what is included in the estate (“any sum recovered as compensation for death of a person caused by a wrongful act, neglect or default, whether by award of damages or settlement of compromise”), and when (date of recovery of the “award or settlement”). N.J.S.A. 54:35-1; N.J.A.C. 18:26-5.3(a). The regulations also indicate what is not taxable, and therefore, what is not includible in an estate. N.J.A.C. 18:26-5.3; 18:26-6.6. Therefore, construing the statutes in pari materia, the court finds that the legislative intent was to include in the decedent's estate, the sums recovered pursuant to the survival claim action, whether the recovery resulted from a trial or a settlement.

Thus, the sums actually recovered by the decedent's estate in the survival claim action represents the value of that claim, which here is $6,709,231.08. Although received or recovered later, this amount is deemed to be the value of the survival action claim as of the decedent's date of death. The legislative changes implemented by L. 1978, c. 172, while noting that it was as to the “date on which certain property is includible in the estate of a decedent for transfer inheritance tax purposes,” sought to address the inequity as to timing of the payment of the tax so that “taxes shall become due and payable on the date of the award of damages or settlement of compromise, rather than the date of death of the decedent.” Even if some ambiguity exists whether this law addresses the timing of the tax payment or the date on which an asset is to be valued, it is resolved by the unambiguous intent that (1) the “property” to be included in the decedent's estate are the “sums recovered under the Death By Wrongful Act Statute,” and (2) the date such “property” is includible in the estate (and therefore subject to tax) is “the date of the award of damages or settlement” and not the date of death. Sen. Rev. Fin. and Approp. Comm. Statement to Senate, No. 348.

It would be counterintuitive to maintain that the same asset (survival claim action) is to be included in the same estate (decedent's) but argue that the tax base, i.e., amount subject to tax, should be different for each type of tax: for the estate tax, it should be an amount based on an appraiser's value conclusion (what is the asset's alleged market value as of the date of death), but for transfer inheritance tax purposes it is the amount recovered under N.J.A.C. 18:26-5.3. Construing the Estate Tax and Transfer Inheritance Tax statutes in pari materia will avoid this absurdity. The court's conclusion does not sidestep the ruling in Estate of Warshaw because there the asset at issue was not a survival action claim and the case did not involve applicability of the Transfer Inheritance Tax laws.

## **Oregon Grabs Out of State QTIP for Estate Tax**

. Don Gillam died in 2012, a Montana resident. His wife, Helene Evans, had shortly before his death moved to Oregon where she lived until her own death in 2015. Mr. Gilman created a testamentary trust for Mrs. Evans that did not qualify for QTIP, but the trustee, a Montana resident, had it reformed so it would achieve the Federal marital deduction. At issue in Estate of Evans v. Department of Revenue, \_\_\_\_ P.3d \_\_\_\_ (Or. 2021), was whether Oregon could tax the QTIP as part of Mrs. Evans’ estate. The court concluded it could stating:

We agree with the department that the cited cases do not establish that a state may impose an estate tax on the assets of an out-of-state trust only if the deceased beneficiary had the ability to control how the assets of that out-of-state trust were managed, invested, or distributed. Instead, based on the rule announced in Kaestner, ––– U.S. ––––, 139 S Ct at 2222, we conclude that the demands of due process also could be satisfied by a showing that a resident decedent had some degree of possession or enjoyment of, or right to receive, the trust property. See Kaestner, ––– U.S. ––––, 139 S Ct at 2223-24 (demonstrating that court looks at whether beneficiaries had some enjoyment or future right to receive trust property, not just at whether they had right to control trust property, when considering “minimum connection” question).

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Applying that standard to this case, we conclude that Evans had sufficient “enjoyment” of the trust principal (in addition to the enjoyment of the income generated thereby) to satisfy Kaestner’s requirement of “some degree of possession, control, or enjoyment” of the trust assets and thus to permit Oregon to include those trust assets in Evans's taxable estate. While, under her husband's modified will, Evans could not claim a right to the whole of the trust principal or any particular portion thereof, she had a potential right to receive distributions of principal, to the extent that trust income was insufficient to satisfy her needs. No other person could receive any part of the principal during Evans's lifetime. And while the remainder beneficiaries had a right to whatever was left of the principal after Evans's death, they could not prevent her from receiving distributions of principal that would reduce or even eliminate their own ultimate shares in the remainder.

Even under the settlement in which Evans ceded her rights with respect to the trust principal under her husband's will and Montana law, she received a substantial one-time payment that consisted of part of the principal. And she retained a potential right to distributions from principal, to the extent that the trust principal failed to generate income sufficient to cover the agreed-upon fixed monthly distribution. In all of those ways, Evans could and did access the trust principal for her own use and benefit in a way that no other person could during her lifetime. We conclude that Evans thereby had a substantial measure of enjoyment of the trust principal. And therefore, under the rule set out in Kaestner, Oregon could rely on Evans's status as an Oregon resident to impose its taxes on that trust principal without violating the Due Process Clause.

We caution, however, that our focus on Evans's enjoyment of the trust assets should not be taken as a conclusion that the circumstances here could not be considered sufficient control of the trust assets. Plaintiff has insisted that Evans never had control of the trust assets in the required sense (“some ability to decide or control how the trust principal will be invested, managed, or distributed”) because the management and distribution of the assets was completely in the hands of the trustee. But plaintiff's description of Evans's rights—or lack thereof—is not entirely accurate. The modified will that controlled the trust clearly contemplated that Evans would receive distributions from the trust assets as “necessary for [her] health, education, maintenance or support in [her] accustomed manner of living.” The fact that it directed that those distributions be in “such amounts from the principal as the trustee determines to be necessary” for that purpose did not foreclose the possibility that Evans could judicially compel distributions of principal to herself, if her needs were not being met. Furthermore, under Montana law, Evans could force the trustee to take certain actions with respect to the trust property if the amount of trust income that he distributed to her was “insufficient to provide [her] with the beneficial enjoyment required to obtain the marital deduction.” MCA § 72-34-445. Evans did ultimately agree to give up those potential claims in exchange for a lump sum payment from principal and a right to a monthly distribution set at a specified amount. But we leave for another day the question of whether such a settlement rendered irrelevant any potential control of the trust principal that beneficiary might have had for purposes of the Kaestner rule or whether the ability to enter into a settlement regarding distribution of the trust assets was itself a demonstration of control. We need not resolve those questions because we conclude that Evans otherwise satisfied Kaestner’s requirement that she have sufficient “possession, control, or enjoyment” of the trust assets to permit Oregon to include the assets in Evans's taxable estate.

Plaintiff, nevertheless, insists that satisfying the Kaestner test is not enough, that due process requires more in this case. Seemingly appealing to a more generic understanding of what the Due Process Clause requires, plaintiff contends that it is confiscatory and unfair to allow Oregon to tax the assets of a Montana trust based solely on the facts that the trust assets were designated as QTIP for purposes of federal estate taxes and that the trust's income beneficiary happened to be living in Oregon when she died. Plaintiff's points in that regard appear to be twofold. First, plaintiff suggests that it is unfair for Oregon to rely on the federal tax QTIP election of Gillam's executor as a statutory basis for including the trust assets in Evans's Oregon estate, when the quid pro quo rationale that justifies the QTIP mechanism—inclusion of the value of trust property in the estate of a surviving spouse in exchange for the earlier deduction of the value of that property from the estate of the original decedent—is not relevant to Evans's Oregon estate (because there had been no earlier deduction from Gillam's estate either in Oregon or Montana). And second, plaintiff suggests that including the trust property in Evans's Oregon estate would be unexpected and arbitrary. According to plaintiff, neither Gillam, in creating the trust with the federal marital deduction in mind, nor his executor, in electing to designate the trust property as QTIP, could have foreseen that the trust assets would thereby become subject to taxation in Oregon, based on the mere happenstance that Evans, the income beneficiary, moved to and died here.

Plaintiff's first argument misapprehends the kind of fairness that the Due Process Clause requires. As explained above, a QTIP election permits a married couple to defer certain taxes that otherwise would be imposed on the estate of the first to die until the death of the survivor. It does so by allowing a deduction of QTIP-designated trust property from the original decedent's estate in exchange for the subsequent inclusion of the same trust property in the estate of the survivor. In the many states that, like Oregon, tie the value of a decedent's estate for state tax purposes to the value of his or her federal estate, a federal QTIP election generally will result in application of the same bargain or exchange to the state taxes that pertain to the affected individuals: Property in a QTIP trust will not be subject to either federal or state estate taxes when the first spouse dies, but will later be subject to both the federal and state taxation as part of the surviving spouse's estate.

We recognize that differences in state tax laws mean that a federal QTIP election will not always produce a corresponding benefit with respect to the original decedent's state-level estate—as here because Montana does not tax estates—yet another state in which the surviving spouse dies includes the trust property in that surviving spouse's taxable estate. That difference in outcome is simply the result of permissible differences in the tax laws of the states that are involved, not a violation of the Due Process Clause.

Plaintiff also suggests that Oregon's inclusion of the trust assets in Evans's Oregon estate is unfair in the sense of being caused by an unforeseen and arbitrary event—plaintiff's relocation to and death in Oregon, a state that has an estate tax and that bases that estate tax on the value of the decedent's federal taxable estate. But, as the department points out, the possibility of incurring additional tax liability depending on where Evans chose to reside was inherent in the election to designate the assets of the Gillam Trust as QTIP and a risk that Gillam's executor knowingly took when he made that election. Evidence of that fact is in Article Fifth of Gillam's modified will, which, in conjunction with authorizing the QTIP election, directs that, upon Evans's death, the trustee of the Gillam Trust shall pay over to the legal representative of her estate such amounts as the trustee shall determine for the payment of “federal and state death taxes \*\*\* imposed by any jurisdiction by reason of [Evans's] death and with respect to any property included in this trust.” (Emphasis added.) Moreover, Evans's move to Oregon was quite the opposite of unforeseen: She moved to Oregon a month before Gillam died, and many months before Gillam's executor even began the process of modifying Gillam's will to allow the QTIP election.

We are persuaded, in fact, that Oregon's inclusion of the assets of the Gillam Trust in Evans's Oregon estate should be considered fair precisely because of the choice by Gillam's executor to designate those assets as QTIP. Our conclusion that Evans's interests in the assets of the trust were such that Oregon's imposition of its estate tax on those assets does not offend due process draws on the specific context of ORS 118.005(7), which bases Oregon's estate tax on the value of a decedent's federal estate; a QTIP election that resulted in a reduction to Gillam's federal estate in exchange for a subsequent increase in Evans's federal estate; and an agreement that the trust—not Evans's heirs—would be liable for any resulting increase in Evans's federal and state estate taxes.

Much of the argument was over the application of the Kaestner income tax case, and three 80 year old cases dealing with state taxation of trusts. The discussion is interesting:

Kaestner is only a starting point, however. Although it sets out a general rule requiring that an in-state trust beneficiary “have some degree of possession, control or enjoyment of the trust property or a right to receive that property” before the state can tax that property, it does not explore what might qualify as “some degree.” The parties point to much earlier Supreme Court cases as sources of additional guidance regarding what it means for a resident of a state to have had “some degree of possession, control or enjoyment” of intangible trust assets such that, upon their death, those trust assets may be taxed as part of their estate. The parties focus their arguments on three estate tax cases, all decided within a two-year period some eighty years ago—Curry, 307 U.S. 357, 59 S.Ct. 900, 83 L.Ed. 1339, Graves v. Elliott, 307 U.S. 383, 59 S Ct 913, 83 L Ed 1356 (1939), and Whitney, 309 U.S. 530, 60 S.Ct. 635, 84 L.Ed. 909.

In the first case, [Curry](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1939121587&pubNum=0000708&originatingDoc=I8f9ab540f0c011ebbb39f6d769114351&refType=RP&originationContext=document&transitionType=DocumentItem&ppcid=65af27e0e979408f8a50dd8ac6920797&contextData=(sc.Search)), a resident of Tennessee had created a trust, funded by stocks and other intangibles, designating herself as the income beneficiary for life and reserving to herself certain powers, including the powers to direct the sale of the trust property and to dispose of the trust property by will. An Alabama corporation was designated as the trustee, and the trust was administered in Alabama and under the laws of that state. 307 U.S. at 360-61, 59 S.Ct. 900. In her will, the trustor bequeathed the trust property to the trustee in trust for the benefit of her husband and children. Id. at 361, 59 S Ct 900.

Upon the trustor's death, Alabama and Tennessee both sought to impose an estate tax on the trust property, and the trustor's executors in Tennessee sought a declaratory judgment in the Tennessee courts as to the two states’ authority in that regard. Id. at 361-62, 59 S Ct 900. On appeal from a Tennessee Supreme Court decision holding that only Tennessee could impose its tax, the United States Supreme Court reversed, holding that both states could impose their transfer taxes consistently with due process. The Court reasoned that Alabama could do so by virtue of the fact that an Alabama trustee had legal ownership of the intangible property, the beneficial interest in which was transferred upon the trustor's death, id. at 370, 59 S Ct 900, while Tennessee could do so because of the in-state residency of a decedent who, in life, had had a right to control the trust property, including by directing its disposition upon her death, id. at 370-71, 59 S Ct 900. With respect to the latter point, the Court explained:

“The decedent's power to dispose of the intangibles was a potential source of wealth which was property in her hands from which she was under the highest obligation in common with her fellow citizens of Tennessee, to contribute to the support of the government whose protection she enjoyed. Exercise of that power, which was in her complete and exclusive control in Tennessee, was made a taxable event by the statutes of the state.”

[Id.](https://1.next.westlaw.com/Link/Document/FullText?findType=Y&serNum=1939121587&pubNum=0000780&originatingDoc=I8f9ab540f0c011ebbb39f6d769114351&refType=RP&originationContext=document&transitionType=DocumentItem&ppcid=65af27e0e979408f8a50dd8ac6920797&contextData=(sc.Search)) The Court noted, too, that “[f]or purposes of taxation, a general power of appointment \*\*\* has hitherto been regarded by this Court as equivalent to ownership of the property subject to the power.” Id. at 371, 59 S Ct 900.

In Graves, the Court reinforced its holding in Curry and clarified that the significance of the power to dispose of intangible property was not limited to an exercise of that power but extended also to a relinquishment of such power at death, through a failure to exercise it in life. The trust at issue in Graves was created by a New York resident who, during her lifetime, had transferred certain intangible property to a bank in Colorado to be held in trust. 307 U.S. at 384-85, 59 S.Ct. 913. The trust agreement provided that the trustee was to pay the income from the trust to the decedent's daughter for life and, thereafter, to the daughter's children until they reached a certain age, at which point the children were to receive a proportionate share of the trust principal. The decedent had reserved to herself the right to remove the trustee, change the trust beneficiaries, or revoke the trust and revest title to the property in herself at any point during her lifetime. Id.

When the decedent died—without exercising any of those reserved rights—New York tax authorities included the intangible property held in the Colorado trust in its assessment of decedent's New York estate, but the New York Court of Appeals held that inclusion of that property infringed due process. Id. at 385-86, 59 S Ct 913. The Supreme Court reversed, emphasizing as it had in Curry that “the power of disposition of property is the equivalent of ownership. It is a potential source of wealth and its exercise in the case of intangibles is the appropriate subject of taxation at the place of the domicile of the owner of the power.” Id. at 386, 59 S Ct 913. As a result, “[t]he relinquishment at death, in consequence of the non-exercise in life, of a power to revoke a trust created by a decedent is likewise an appropriate subject of taxation.” Id. Relying on its reasoning in Curry, the Court concluded:

“[W]e cannot say that the legal interest of decedent in the intangibles held in trust in Colorado was so dissociated from her person as to be beyond the taxing jurisdiction of the state of her domicile more than her other rights in intangibles. Her right to revoke the trust and to demand the transmission to her of the intangibles by the trustee and the delivery to her of their physical evidences was a potential source of wealth, having the attributes of property. As in the case of any other intangibles which she possessed, control over her person and estate at the place of her domicile and her duty to contribute to the support of government there afford adequate constitutional bases for imposition of a tax measured by the value of the intangibles transmitted or relinquished by her at death.”

Id. at 386-87, 59 S.Ct. 913.

The final case that we consider, Whitney, differs from Curry and Graves in that the due process question had nothing to do with where intangible property held in trust may be taxed constitutionally and therefore did not include any discussion that might clarify the due process “minimum connection” requirement. The trust at issue in Whitney was established and funded in New York by the will of Cornelius Vanderbilt. It provided for an annual income to Vanderbilt's wife and also gave Mrs. Vanderbilt the power to dispose of the trust principal among the couple's four children in her will, in such proportions as she might choose. The trust further provided that, if Mrs. Vanderbilt did not exercise that “special power of appointment” in her will, then the trust property would be divided equally among the four children upon her death. 309 U.S. at 534-35, 60 S.Ct. 635. Mrs. Vanderbilt did exercise the power of appointment in her will and, upon her death, the taxing authorities of New York (where the trust was administered and Mrs. Vanderbilt had at all times resided) included the value of the trust principal in Mrs. Vanderbilt's gross estate for purposes of calculating the state's estate tax. Mrs. Vanderbilt's beneficiaries and executors challenged New York's inclusion of the trust principal in her estate, arguing that doing so violated the Due Process Clause, given that Mrs. Vanderbilt had not been the “beneficial owner” of the trust corpus—by which the challengers meant that she could not use the corpus of the trust herself, could not appoint it to her own estate, and could not direct it to her creditors. Id. at 535-38, 60 S Ct 635.

The Supreme Court rejected the due process challenge. The Court explained that, to the extent that New York's estate tax statute was aimed at diverting to the community a portion of the total wealth released by a death, the state was

“not confined to that kind of wealth which was, in colloquial language, ‘owned’ by a decedent before death, nor even to that over which he had an unrestricted power of testamentary disposition.”

Id. at 538, 60 S.Ct. 635. Instead,

“[i]t is enough that one person acquires economic interests in property through the death of another person, even though such acquisition is in part the automatic consequence of death or related to the decedent merely because of his power to designate to whom and in what proportions among a restricted class the benefits shall fall.”

Id. at 538-39, 60 S.Ct. 635. After pointing to various other circumstances in which property not “beneficially owned” by a decedent may nevertheless be included in his or her estate, the Court made an even more expansive statement:

“A person may by his death bring into being greater interests in property than he himself has ever enjoyed, and the state may turn advantages thus realized into a source of revenue[.] \* \* \* [I]f death may be made the occasion for taxing property in which the decedent had no ‘beneficial interest,’ then the measurement of that tax by the decedent's total wealth-disposing power is merely an exercise of legislative discretion in determining what the state shall take in return for allowing the transfer.”

Id. at 539-40, 60 S.Ct. 635 (emphasis added).

1. The “Sensible Taxation and Equity Promotion Act of 2021.” [↑](#footnote-ref-2)
2. There is proposed legislative language, but the STEP Act has not been formally introduced. [↑](#footnote-ref-3)
3. In addition to Senator Van Hollen, Senators Booker, Sanders, Whitehouse and Warren signed on to the STEP Act discussion draft. [↑](#footnote-ref-4)
4. In addition to Senator Sanders, Senators Gillibrand, Whitehouse, Van Hollen and Reed signed on to the For the 99.5% Act. [↑](#footnote-ref-5)
5. The formal title of the Greenbook is “General Explanations of the Administration’s Fiscal Year 2022 Revenue Proposals.” [↑](#footnote-ref-6)
6. It would appear, however, that the proposal to increase the long-term capital gains tax rate would be effective as to gains required to be recognized after April 28, 2021 (the “date of announcement”). [↑](#footnote-ref-7)