Legacy Bridge
Private Family Offices

What You Don't Know Can Hurt You — A Review of Recent Developments in Estate and Gift Taxation and Administration

Tuesday, May 7, 2019
2:00 p.m. – 4:00 p.m.

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The McGuireWoods LLP Private Wealth Services Group welcomes your questions or comments about these seminar materials. Please feel free to contact any member of the Group.

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TABLE OF CONTENTS

LEGISLATIVE AND REGULATORY DEVELOPMENTS 1

1. Revenue Procedure 2018-57 (November 15, 2018) 1
2. 2018-2019 Priority Guidance Plan (November 8, 2018) 5
3. Proposed Treasury Regulation § 20.2010-1(c) (November 20, 2018) 6
4. IRS Issues Final Regulations on Section 199A (January 18, 2019) 10
5. Notice 2018-54, 2018-24 IRB 750 (May 23, 2018) 15
6. Press Release: Treasury Issues Proposed Rule on Charitable Contributions and State and Local Tax Credits (August 23, 2018) 15
7. Letter Rulings on Extension of Time to Make Portability Election 16

MARITAL DEDUCTION 16

8. Letter Ruling 201751005 (Issued September 18, 2017; Released December 22, 2017) 16

GIFTS 17

9. Karen S. True v. Commissioner, Tax Court Docket No. 21896-16 and H. A. True III v. Commissioner, Tax Court Docket No. 21897-16 (Petitions filed October 11, 2016) 17
10. Letter Ruling 201803003 (Issued October 6, 2017; Released January 9, 2018) 17
11. Letter Ruling 201808002 (Issued November 16, 2017; Released February 23, 2018) 20
12. Letter Ruling 201825003 (Issued March 9, 2018; Released June 22, 2018) 21
13. Letter Ruling 201836006 (Issued May 30, 2018; Released September 7, 2018) 21

ESTATE INCLUSION 23

14. CCA 201745012 (Issued August 4, 2017; Released November 9, 2017) 23
15. Badgley v. United States, _____ F.Supp.3d _____ (N.D. Cal 2018) 24

VALUATION 25

16. Letter Ruling 201819010 (Issued February 8, 2018; Released May 11, 2018) 25
17. Letter Ruling 201814004 (Issued December 11, 2017; Released April 6, 2018) 26
18. Letter Ruling 201820010 (Issued February 13, 2018; Released May 18, 2018) 26

19. Letter Ruling 201815001 (Issued December 11, 2017; Released April 13, 2018) 27
20. Letter Ruling 201825013 (Issued March 19, 2018; Released June 22, 2018) 27
21. Estate of Clara M. Morrissette v. Commissioner, Tax Court Order, Docket No. 4414-14 (June 21, 2018) 28
22. Cahill v. Commissioner, T.C. Memo 2018-84 31
23. Streightoff v. Commissioner, T.C. Memo 2018 - 178 33
24. Estate of Turner v. Commissioner, 151 T.C. No. 10 (2018) (Turner III) 35
CHARITABLE GIFTS 38
25. Letter Ruling 201845014 (Issued August 9, 2018; Released November 9, 2018) 38
26. Wendell Falls Development, LLC v. Commissioner, T.C. Memo 2018-45; motion for reconsideration denied, T.C. Memo 2018-193 40
27. Champions Retreat Golf Founders, LLC v. Commissioner, T.C. Memo 2018-146 41
28. Belair Woods, LLC v. Commissioner, T.C. Memo 2018 - 159 42
29. Notice 2017-73, 2017-51 IRB 562 (December 4, 2017) 44
GENERATION-SKIPPING TRANSFER TAX 45
30. Letter Rulings 201820007 and 201820008 (Issued February 5, 2018; Released May 18, 2018) 45
31. Letter Ruling 201815012 (Issued November 14, 2017; Released April 13, 2018) 45
32. Letter Ruling 201801001 (Issued September 20, 2017; Released January 5, 2018) 46
33. Letter Rulings 201803001 and 201803002 (Issued September 18, 2017; Released January 19, 2018) 46
34. Letter Ruling 201840002 (Issued July 2, 2018; Released October 5, 2018) 47
35. Letter Ruling 201839001 (Issued June 18, 2018; Released September 28, 2018) 47
36. Letter Rulings 201849007 and 201849008 (Issued July 31, 2018; Released December 7, 2018) 48
37. Letter Ruling 201850010 (Issued September 17, 2018; Released December 14, 2018) 48
38. Letter Rulings 201839003 (Issued June 18, 2018; Released September 28, 2018), and 201839012, and 201839014 (Issued June 21, 2018; Released September 28, 2018) 49

39. Letter Rulings 201836004 and 201836007 (Issued June 5, 2018; Released September 7, 2018) ... 49

40. Letter Rulings 201811002 and 201811003 (Issued November 27, 2017; Released March 16, 2018) ... 50

41. Letter Rulings 201814001 and 201814002 (Issued December 11, 2017; Released April 6, 2018) ... 51

42. Letter Ruling 201818005 (Issued January 16, 2018; Released May 4, 2018) ... 52

43. Letter Ruling 201825007 (Issued March 15, 2018; Released June 22, 2018) ... 53

44. Letter Ruling 201825023 (Issued March 9, 2018; Released June 22, 2018) ... 54

FIDUCIARY INCOME TAX ... 55

45. Letter Ruling 201807001 (Issued November 13, 2017; Released February 16, 2018) ... 55

46. Letter Ruling 201803004 (Issued September 28, 2017; Released January 19, 2018) ... 55

47. Green v. United States, 880 F.3d 519 (10th Cir. 2018) ... 56

48. Kimberly Rice Kaestner 1992 Family Trust v. North Carolina Department of Revenue, 371 N.C. 133 (2018); Petition for Writ of Certiorari granted on January 11, 2019 by U.S. Supreme Court ... 58

49. Fielding v. Commissioner, 916 N.W.2d 323 (Minn. 2018) ... 59

50. South Dakota v. Wayfair, Inc., ___ U.S. ___ (2018) ... 61

51. Notice 2018-61, 2018-31 IRB (July 13, 2018) ... 62

ASSET PROTECTION ... 64

52. Georgia House Bill 441 (2018) ... 64

53. Toni 1 Trust v. Wacker, 413 P.2d 1199 (AK 2018) ... 65

54. Olson v. Marshack, ___ F. Supp. 3d ___ (C.D. Cal. 2018) ... 66

FIDUCIARY CASES ... 68

55. Ajemian v. Yahoo!, Inc., 84 N.E. 3d 766 (Mass. 2017), petition for cert. docketed sub nom. Oath Holdings, Inc. v. Ajemain (U.S. Jan. 19, 2018 (No. 17-1005) ... 68

56. Laborers' Pension Fund v. Miscevic, No. 17-2022 (7th Cir. Jan. 29, 2018) ... 69

57. Lynch v. Barba, 2018 WL 1613834, C.A. No. 12083-MG (Del. Ch. Ct. 2018) ... 70

58. Bullard v. Hoffman (In re Mayette E. Hoffman Living Trust U/A dated August 4, 1997), 812 S.E.2d 401 (N.C. Ct. App. 2018) ... 72

59. In Estate of Forgey, 298 Neb. 865 (2018) ... 73

60. Morgan v. Superior Court of Orange County, 23 Cal. Rptr. 3d 647 (Cal. App. 2018) ... 74

61. Carberry v. Kaltschmid, 2018 WL 2731898 (Cal. 2018) ... 76

62. Doermer v. Oxford Fin. Grp., Ltd., 884 F.3d 643, 647 (7th Cir. 2018) ... 76

63. Estate of Lee, 2018 WL 2374116 (Texas 2018) ... 78

64. Rachins v. Minassian, 2018 WL 3387236 (Florida 2018) ... 79

65. Trudel v. SunTrust Bank, 288 F. Supp. 3d 239 (D.D.C. 2018) ... 80

66. EGW v. First Federal Savings Bank of Sheridan, 413 P.3d 106 (2018) ... 82

67. In the Matter of the Will of E. Warren Bradway, 2018 WL 3097060 (N.J. Sup. Ct. App. Div., June 25, 2018) ... 84

68. Horgan v. Cosden, 2018 WL 2374443 (Fla. Dist. Ct. App. May 25, 2018), review denied, No. SC18-1112, 2018 WL 3650268 (Fla. July 30, 2018) ... 85

69. In Estate of Burkhalter, 806 S.E.2d 875 (Ga. Ct. App. 2017) ... 86

OTHER ITEMS OF INTEREST ... 87

70. Sveen v. Melin _____ U.S. _____ (2018) ... 87

71. Letter Ruling 201839005 (Issued June 25, 2018; Released September 28, 2018) ... 89

72. United States v. Jan M. Mengedoht, ______, F. Supp. 3d ______ (Dist. Neb. 2019) ... 89

73. Berkenfeld v. Lenet, _______ F.Supp.3d ________ (D.Md. 2018) ... 90

74. Letter Ruling 201805011 (Issued November 2, 2017; Released February 2, 2018) ... 92

75. United States v. Paulson, 204 F. Supp. 3d 1102 (S.D. Cal. 2018) ... 92

76. Comptroller of the Treasury v. Taylor, 189 A.3d 799 (Md. Ct. Spec. App. July 25, 2018), In re Estate of Seiden, NYLJ 10/12/18 p. 23, col. 5 (N.Y. County Surr. Ct.) ... 95

77. Changes in State Death Taxes in 2018 and 2019 ... 96

78. 2019 State Death Tax Chart (as of January 26, 2019) ... 98

WHAT YOU DON'T KNOW CAN HURT YOU — A REVIEW OF RECENT DEVELOPMENTS IN ESTATE AND GIFT TAXATION AND ADMINISTRATION[1]

LEGISLATIVE AND REGULATORY DEVELOPMENTS

1. Revenue Procedure 2018-57 (November 15, 2018)

IRS announces inflation adjustments for 2019

The following are some of the inflation adjustments for 2019.

1. Tax Rate Tables

TABLE 1 – Married Individuals Filing Joint Returns and Surviving Spouses

If Taxable Income is:	The Tax is:
Not over $19,400	10% of the taxable income
Over $19,400 but not over $78,950	$1,940 plus 12% of the excess over $19,400
Over $78,950 but not over $168,400	$9,086 plus 22% of the excess over $78,950
Over $168,400 but not over $321,450	$28,765 plus 24% of the excess over $168,400
Over $321,450 but not over $408,200	$65,497 plus 32% of the excess over $321,450
Over $408,200 but not over $612,350	$93,257 plus 35% of the excess over $408,200
Over $612,350	$164,709.50 plus 37% of The excess over $612,350

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

TABLE 2 – Heads of Household

If Taxable Income is:	The Tax is:
Not over $13,850	10% of the taxable income
Over $13,850 but not over $52,850	$1,385 plus 12% of the excess over $13,850
Over $52,850 but not over $84,200	$6,065 plus 22% of the excess over $52,850
Over $84,200 but not over $160,700	$12,962 plus 24% of the excess over $84,200
Over $160,700 but not over $204,100	$31,322 plus 32% of the excess over $160,700
Over $204,100 but not over $510,300	$45,210 plus 35% of the excess over $204, 100
Over $510,300	$152,380 plus 37% of the excess over $510,300

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

If Taxable Income is:	The Tax is:
Not over $9,700	10% of the taxable income
Over $9,700 but not over $39,475	$970 plus 12% of the excess over $9,700
Over $39,475 but not over $84,200	$4,543 plus 22% of the excess over $39,475
Over $84,200 but not over $160,725	$14,382.50 plus 24% of the excess over $84,200
Over $160,725 but not over $204,100	$32,748.50 plus 32% of the excess over $160,725
Over $204,100 but not over $510,300	$46,628.50 plus 35% of the excess over $204, 100

Over $510,300	$153,798.50 plus 37% of the excess over $510,300

TABLE 4 – Married Individuals Filing Separate Returns

<u>If Taxable Income is</u>:	<u>The Tax is:</u>
Not over $9,700	10% of the taxable income
Over $9,700 but not over $39,475	$970 plus 12% of the excess over $9,700
Over $39,475 but not over $84,200	$4,543 plus 22% of the excess over $39,475
Over $84,200 but not over $160,725	$14,382.50 plus 24% of the excess over $84,200
Over $160,725 but not over $204,100	$32,748.50 plus 32% of the excess over $160,725
Over $204,100 but not over $306,175	$46,628.50 plus 35% of the excess over $204,100
Over $306,175	$82,354.75 plus 37% of the excess over $306,175

TABLE 5 – Estates and Trusts

<u>If Taxable Income is</u>:	<u>The Tax is:</u>
Not over $2,600	10% of the taxable income
Over $2,600 but not over $9,300	$260 plus 24% of the excess over $2,600
Over $9,300 but not over $12,750	$1,868 plus 35% of the excess over $9,300
Over $12,750	$3,075.50 plus 37% of the excess over $12,750

2. Standard Deductions

For taxable years beginning in 2019, the standard deduction amounts under Section 63(c)(2) are as follows:

Filing Status	Standard Deduction
Married Individuals Filing Joint Returns and Surviving Spouses	$24,400
Heads of Households	$18,350
Unmarried Individuals (other Than Surviving Spouses and Heads of Households)	$12,200
Married Individuals Filing Separate Returns	$12,200

3. Qualified Business Income Under Section 199A

For taxable years beginning in 2019, the threshold amount under Section 199(e)(2) is $321,400 for married filing joint returns, $160,725 for married filing separate returns, and $160,700 for single and head of household returns.

4. Basic Exclusion Amount

For an estate of any decedent dying in calendar year 2019, the basic exclusion amount is $11,400,000 for determining the amount of the unified credit against estate tax under Section 2010. The unified credit is $4,505,800.

5. Annual Exclusion for Gifts

(1) For calendar year 2019, the first $15,000 of gifts to any person (other than gifts of future interests in property) are not included in the total amount of taxable gifts under Section 2503 made during that year.

(2) For calendar year 2019, the first $155,000 of gifts to a spouse who is not a citizen of the United States (other than gifts of future interests in property) are not included in the total amount of taxable gifts under Section 2503 and 2523(i)(2) made during that year.

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

For an estate of a decedent dying in calendar year 2019, the dollar amount used to determine the "2-percent portion" (for purposes of calculating interest under Section 6601(j)) of the estate tax extended as provided in Section 6166 is $1,550,000.

2. 2018-2019 Priority Guidance Plan (November 8, 2018)

Treasury Department and Internal Revenue Service release their 2018-2019 Priority Guidance Plan

On November 8, 2018, the Treasury Department and the Internal Revenue Service released their 2018-2019 Priority Guidance Plan which lists those projects which will be the focus of the IRS's efforts during the twelve-month period from July 1, 2018 through June 30, 2019. The 2018-2019 Priority Guidance Plan contains 239 guidance projects of which guidance on 45 items had been released as of October 31, 2018. Each item listed below is identified by the number given in the different parts of the Priority Guidance Plan.

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

3. Guidance clarifying the deductibility of certain expenses described in Section 67(b) and (e) that are incurred by estates and non-grantor trusts. This guidance was published as Notice 2018-61 in 2018-31 I.R.B (released July 13, 2018).

13. Final regulations on computational, definitional, and anti-avoidance rules under new Sections 199A and 643(f). Proposed regulations on computational, definitional, and anti-avoidance guidance under new Sections 199A and 643(f) were released on August 8, 2018.

14. Revenue procedure on methods for calculating W-2 wages for purposes of new Section 199A. A notice of a proposed revenue procedure on this was released on August 8, 2018.

15. Regulations under Section 199A and other guidance for cooperatives and their patrons.

16. Guidance on methods for calculating W-2 wages for purposes of new Section 199A for cooperatives and their patrons.

37. Regulations under Section 2010 addressing the computation of the estate tax in the event of a difference between the basic exclusion amount applicable to gifts and that applicable at the donor's date of death. This will address any possible "claw back" concerns if the estate and gift tax exemption reverts to $5 million adjusted for inflation in 2026. Proposed Regulations on this were issued on November 20, 2018.

40. Regulations on the excise tax on the net investment income of certain private colleges and universities under new Section 4968.

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

4. Final regulations under Sections 1014(f) and 6035 regarding basis consistency between estates and persons acquiring property from a decedent. Proposed and temporary regulations were published on March 4, 2016.

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

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

11. Guidance under Treas. Reg. Section 301.9100 regarding relief for late regulatory elections.

Part 5. General Guidance. The section on gifts and estates and trusts in Part 5 includes the following items:

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

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

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

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

The first three items were carried over from the 2017-2018 priority guidance plan. The fourth item is new.

3. Proposed Treasury Regulation § 20.2010-1(c) (November 20, 2018)

Treasury Department issues proposed anti-clawback regulations

Proposed Regulations (REG-106706-18) were released on November 20, 2018, and published in the Federal Register on November 23, 2018 (83 Fed. Treas. Reg. 59343), to prevent the "clawback" of the benefits of the doubled federal gift tax exemption during 2018 through 2025 if

the "sunset" of those benefits occurs in 2026 as currently scheduled and the donor dies in 2026 or later. Although neither the statute nor the proposed regulations use the word "clawback," the regulations would carry out the mandate of the 2017 Tax Act in new Section 2001(g)(2), which provides that Treasury "shall prescribe such regulations as may be necessary or appropriate to carry out this Section with respect to any difference between (A) the basic exclusion amount under Section 2010(c)(3) applicable at the time of the decedent's death, and (B) the basic exclusion amount under such Section applicable with respect to any gifts made by the decedent."

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

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

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

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

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

Contemporaneously with the release of the proposed regulations, the IRS issued a news release with the reassuring headline of "Treasury, IRS: Making large gifts now won't harm estates after 2025." The press release includes an even simpler explanation that "the proposed regulations

provide a special rule that allows the estate to compute its estate tax credit using the higher of the BEA [basic exclusion amount] applicable to gifts made during life or the BEA applicable on the date of death."

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

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

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

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

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

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

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

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

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

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

4. IRS Issues Final Regulations on Section 199A (January 18, 2019)

IRS proposes final regulations on passthrough deduction under new Section 199A

On January 18, 2019, the Internal Revenue Service (IRS) and the Department of the Treasury released regulations on new Section 199A, the 20 percent deduction for qualified business income, added to the Internal Revenue Code by the 2017 Tax Act. A revised version of the final regulations was issued on February 1, 2019 to make some corrections in the January 18th version of the final regulations.

Revenue Procedure 2019-11 was also issued on January 18, 2019. This revenue procedure provides methods for calculating W-2 wages for purposes of Section 199A. Notice 2019-07 was issued as well on January 18, 2019. This notice contains a proposed revenue procedure to provide a safe harbor permitting a rental real estate enterprise to be treated as a trade or business under Section 199A. Finally, proposed regulations were issued to address matters not addressed in either the August 8th proposed regulations or the January 18th final regulations.

While the proposed regulations issued on August 8, 2018 provided guidance to taxpayers and practitioners on significant issues that arose with the enactment of the new 20 percent deduction, they left many significant issues unaddressed, many of which have been addressed in the final regulations.

The final regulations under Section 199A provide definitional, computational, and anti-avoidance guidance helpful in determining the appropriate deductible amount. Additionally, the IRS and Treasury proposed regulations under Section 643(f) that contain anti-avoidance provisions with respect to the use of multiple nongrantor trusts to circumvent the purpose of Section 199A. The Section 199A proposed regulations contain six sections, each briefly summarized below.

Background

Section 199A provides generally that taxpayers other than corporations may claim a deduction for 20 percent of their qualified business income from a partnership, S corporation, or sole

proprietorship. These passthrough entities are referred to as "Relevant Passthrough Entities" (RPEs). "Qualified business income" for purposes of Section 199A is defined generally as the net amount of income, gain, deduction, and loss with respect to the qualified trade or business, excluding certain investment-related income and guaranteed payments to partners in a partnership. A "qualified trade or business" is defined generally as any trade or business except the trade or business of performing services as an employee and any specified service trade or business (SSTB).

The deduction under Section 199A is limited generally to the greater of: (1) 50 percent of the W-2 wages of the trade or business for the taxable year, or (2) the sum of 25 percent of such wages and 2.5 percent of the unadjusted basis immediately after acquisition of all qualified property for the taxable year (referred to awkwardly in the regulations as "UBIA of qualified property"). The W-2 wage and UBIA of qualified property limitations do not apply to taxpayers with a taxable income of less than $157,500 ($315,000 for married couples filing jointly) adjusted for inflation and is phased in for taxpayers with taxable income above that threshold amount. The thresholds for 2019 are $160,700 for single taxpayers and heads of household, $160,725 for married taxpayers filing separately, and $321,400 for married taxpayers filing joint returns. Finally, the Section 199A deduction cannot exceed the taxpayer's taxable income over net capital gain for the tax year.

Operational Rules

The first Section of the regulations under Section 199A provides guidance on the determination of the Section 199A deduction generally. The regulations clarify that, for purposes of Section 199A, the term "trade or business" should be interpreted in a manner consistent with the guidance under Section 162, which provides a deduction for ordinary and necessary business expenses. The regulations under Section 199A, however, expand the traditional definition under Section 162 to include certain rental or licensing of property to related parties under common control.

This first Section also provides guidance on computing the deduction for a taxpayer that has taxable income above, at, or below the threshold amount for applying the W-2 wage and UBIA of qualified property limitations. In doing so, the IRS and Treasury prescribe computational rules, including rules for determining carryover losses and for the treatment of qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership (PTP) income.

Finally, the first Section of the regulations provides that the Section 199A deduction is applied at the partner or shareholder level. The deduction does not affect the adjusted basis of a partner's interest in a partnership, the adjusted basis of a shareholder's stock in an S corporation, or an S corporation's accumulated adjustments account.

Determination of W-2 Wages and the UBIA of Qualified Property

The second section of the regulations prescribes rules for determining W-2 wages and the UBIA of qualified property. The regulations provide that W-2 wages of a qualified trade or business are determined generally using the rules that applied under former Section 199 with respect to the domestic production activities deduction. The IRS and Treasury state in the preamble of the

proposed Section 199A regulations that Notice 2018-64, issued concurrently with the regulations, provides three methods for calculating the W-2 wages of a qualified trade or business.

Additionally, the second section of the regulations addresses many issues concerning the UBIA of qualified property, including its allocation among relevant passthrough entities, subsequent improvements to the qualified property, and the effect of certain nonrecognition transactions (for example, like-kind exchanges). The regulations put in place guardrails to prevent taxpayers from gaming the system. For example, the regulations indicate that property is not qualified property if a taxpayer acquires and disposes of the property in a short period unless the taxpayer demonstrates that the principal purpose of the acquisition and disposition was not to increase the Section 199A deduction.

Qualified REIT Dividends and Qualified Publicly Traded Partnership Income

The third section of the regulations restates the definition of qualified business income (QBI) and provides additional guidance on the determination of QBI, qualified REIT dividends, and qualified PTP income. The regulations describe in further detail the exclusions from QBI, including capital gains, interest income, reasonable compensation, and guaranteed payments. With respect to qualified REIT dividends, the regulations contain an anti-abuse rule to prevent dividend-stripping and similar transactions aimed at increasing the qualified REIT dividends without having a corresponding economic exposure.

Aggregation Rules

The fourth section of the regulations addresses rules for aggregating multiple trades or businesses for the purposes of applying the computational rules of Section 199A. Commentators urged the IRS to apply the grouping rules for determining passive activity loss and credit limitation rules under Section 469. The IRS concluded that the rules under Section 469 were inappropriate for purposes of Section 199A, but did agree with commentators that aggregation should be permitted.

The regulations create a four-part test for aggregation. First, each trade or business a taxpayer proposes to aggregate must itself be a trade or business as defined by the regulations. Second, the same person, or group of persons, must own, directly or indirectly, a majority interest in each of the businesses for the majority of the taxable year. The regulations provide rules allowing for family attribution for this purpose. Third, none of the trades or businesses can be an SSTB. Finally, the trade or business must meet at least two of the three following characteristics:

(1) The businesses provide products and services that are the same or typically provided together.

(2) The businesses share facilities or significant centralized elements.

(3) The businesses are operated in coordination with each other.

Under the regulations, an individual taxpayer may aggregate trades or businesses operated through multiple passthrough entities; however, the taxpayer must determine the QBI, W-2

wages, and UBIA of qualified property for each trade or business separately before applying the aggregation rules. The regulations also permit a RPE to aggregate separate businesses that are operated either directly or through lower-tier RPEs.

Specified Service Trade or Business and the Trade or Business of Performing Services as an Employee

The fifth section of the regulations contains substantial guidance on the definition of an SSTB. Under Section 199A, if a trade or business is an SSTB, none of its items are taken into account for determining a taxpayer's QBI. A taxpayer who owns an SSTB conducted through an entity, such as an S corporation or partnership, is treated as engaged in an SSTB for purposes of Section 199A, regardless of the taxpayer's actual level of participation in the trade or business.

Notwithstanding the general rule, taxpayers with taxable income of less than $157,500 ($315,000 for married couples filing jointly) as adjusted for inflation may claim a deduction under Section 199A for QBI received from an SSTB. The Section 199A deduction phases out for taxpayers with taxable incomes over this threshold amount. If a trade or business is conducted by a passthrough entity, the phase-out threshold is determined at the individual, trust, or estate level, not at the level of the passthrough entity. Accordingly, a passthrough entity conducting an SSTB could have taxable income below the threshold amount but have no owners eligible for a Section 199A deduction because each of them has taxable income above the threshold amount (plus $50,000 or $100,000 in the case of a married couple filing jointly).

The regulations also attempt to combat what commentators have called the "crack and pack" strategy. Under this strategy, a business that would otherwise be an SSTB separates all its administrative functions into a separate entity to qualify that separate entity for the Section 199A deduction. To minimize the potential for this abuse, the regulations provide that an SSTB includes any trade or business with 50 percent or more common ownership. The final regulations deleted the 80 percent requirement (that the SSTB with 50 percent of more common ownership also provide 80 percent or more of its property or services to SSTB). The Service agreed with commentators that this require was unnecessary.

The regulations contain a lengthy and detailed definition of an SSTB. Generally, the regulations state that the existing guidance defining a "qualified personal service corporation" under Sections 448 and 1202 informs the definition of an SSTB under Section 199A. Pursuant to Section 199A(d)(2)(A), which incorporates the rules of Section 1202(e)(3)(A), an SSTB is any trade or business in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, investing, investment management, or trading or dealing in securities, or any trade or business where the principal asset is the reputation or skill of one or more of its employees or owners. The regulations limit "reputation or skill" to trades or businesses involving the receipt of income for endorsing products or services, licensing or receiving income for the use of an individual's publicity rights, or receiving appearance fees.

The Service deleted the Business Incidental to an SSTB Test from the final regulations. As a result, the common control of an SSTB and a non SSTB will not causes to non SSTB to be treated as part of the SSTB. This differs from the situation in which an SSTB and a non SSTB are part of the same business

The common law and statutory rules used to determine whether an individual is an employee for federal employment tax purposes apply to determining whether an individual is engaged in the trade or business of performing services as an employee for purposes of Section 199A. The

regulations also create a presumption that an individual who was treated as an employee for federal income tax purposes but is subsequently treated as other than an employee with respect to the same services is still engaged in the trade or business of performing services as an employee for purposes of Section 199A. The presumption attempts to prevent taxpayers from reclassifying employees as independent contractors in order to claim a Section 199A deduction.

Special Rules for Passthrough Entities, Publicly Traded Partnerships, Trusts, and Estates

The sixth section of the regulations contains special rules for passthrough entities, PTPs, nongrantor trusts, and estates. Passthrough entities, including S corporations and entities taxable as partnerships for federal income tax purposes, cannot claim a deduction under Section 199A. Any passthrough entity conducting a trade or business, along with any PTP conducting a trade or business, must report all relevant information — including QBI, W-2 wages, UBIA of qualified property, qualified REIT dividends, and qualified PTP income — to its owners so they may determine the amount of their respective Section 199A deductions.

The regulations require that a nongrantor trust or estate conducting a trade or business allocate QBI, expenses properly allocable to the trade or business, W-2 wages, and UBIA of qualified property among the trust or estate and its beneficiaries. The allocation is based on the ratio that the distributable net income (DNI) distributed or deemed distributed to each beneficiary bears to the trust's or estate's total DNI for the taxable year. Any DNI not distributed is allocated to the nongrantor trust or estate itself. UBIA of qualified property is allocated without taking into account how depreciation deductions are allocated among the beneficiaries under Section 643(c). When calculating the threshold amount for purposes of applying the W-2 wage and UBIA limitations, unlike the proposed regulations, the final regulations provide that taxable income is computed at the trust or estate level taking into account any distributions of DNI.

For purposes of the Section 199A regulations, a qualified subchapter S trust (QSST) is treated as a grantor trust. The individual treated as the owner of the QSST is treated as having received QBI directly from the trade or business and not through the QSST.

The final regulations treat the S and non-S portions of an Electing Small Business Trust (ESBT) as a single trust when determining the threshold amount for the ESBT.

Anti-avoidance Guidance for Multiple Nongrantor Trusts

In addition to finalizing regulations under Section 199A, the IRS and Treasury finalized regulations under Section 643(f) designed to prevent taxpayers from manipulating the Section 199A deduction using multiple nongrantor trusts. Section 643(f) allows Treasury to prescribe regulations to prevent taxpayers from establishing multiple nongrantor trusts to avoid federal income tax. The regulations under Section 643(f) provide that when two or more trusts have the same grantor or grantors and substantially the same primary beneficiary or beneficiaries, and a purpose of such trusts is to avoid federal income tax, all of such trusts will be treated as a single trust for federal income tax purposes. Absent this anti-abuse rule, taxpayers could own a trade or business through multiple nongrantor trusts such that each trust would have taxable income below the threshold amount for applying the W-2 wage and UBIA limitations on the Section 199A deduction.

5. **Notice 2018-54, 2018-24 IRB 750 (May 23, 2018)**

IRS provides guidance on certain payments made in exchange for state and local tax credits

The purpose of this notice is to inform taxpayers that the Treasury Department and the IRS intend to propose regulations addressing the federal income tax treatment of certain payments made by taxpayers for which taxpayers receive a credit against their state and local taxes.

The 2017 Tax Act limited an individual taxpayer's deduction for the aggregate amount of state and local taxes paid during the calendar year to $10,000. State and local tax payments in excess of those amounts are not deductible. This new limitation applies to taxable years from 2018 through 2025. In response to this new limitation, some state legislatures are considering or have adopted proposals that would allow taxpayers the make transfers to funds controlled by state or local governments or other specified transfers in exchange for credits against the state or local taxes that the taxpayer is required to pay. The aim of the proposals is to allow taxpayers to characterize such transfers as fully deductible charitable contributions for federal income tax purposes while using the same transfers to satisfy state or local tax liabilities.

The notice warns taxpayers that despite these state efforts to circumvent the new $10,000 limitation on the deduction of state and local taxes, they should be mindful that federal law controls the proper characterization of payments for federal income tax purposes. Proposed regulations will be issued to make it clear that the requirements of the Internal Revenue Code, informed by substance over form principles, will govern the federal income tax treatment of such transfers.

6. **Press Release: Treasury Issues Proposed Rule on Charitable Contributions and State and Local Tax Credits (August 23, 2018)**

Department of Treasury issues proposed rule on federal income tax treatment of payments and property transfers under state and local tax credit programs

The Treasury Department released this proposed rule to prevent charitable contributions from being used to circumvent the new limitation on state and local taxation under the 2017 Tax Act. The 2017 Tax Act limited the amount of state and local taxes that an individual could deduct to $10,000 per year. Several states have enacted or are considering tax credit programs to "circumvent" the $10,000 limit of the 2017 Tax Act.

The Treasury Department stated that the proposed rule is a straightforward application of a long-standing principal of tax law: when a taxpayer receives a valuable benefit in return for a donation to charity, the taxpayer can deduct only the net value of the donation of a charitable contribution. The rule applies that quid pro quo principle to state tax benefits provided to the donor in return for contributions.

The press release gives the following example: if a state grants a 50 percent credit and the taxpayer contributes $1,000, the allowable charitable contribution may not exceed $500. The

proposed rule provides an exception for dollar-for-dollar state and local tax deductions and tax credits of no more than 15 percent of the payment amount of the fair market value of the property transferred. These guidelines will apply to both new and existing tax credit programs.

The press release also noted that because of the increase in the standard deduction of the 2017 Tax Act the Treasury Department projects that 90 percent of taxpayers will not itemize under the new tax law. It also estimates that approximately 5 percent of taxpayers will itemize and have state and local income tax deductions above the $10,000 cap. The Treasury Department also expects that only about 1 percent of taxpayers will see an effect on the tax benefits for donations to school choice tax credit programs.

7. Letter Rulings on Extension of Time to Make Portability Election

Extension of time to make portability election permitted

Numerous letter rulings (too numerous to list) have been, and continue to be, issued on the same fact pattern. Decedent's estate was less than the applicable exclusion amount in the year of decedent's death. Decedent's estate failed to file a federal estate tax return to make the portability election and discovered its failure to elect portability after the due date for making the election. In each letter ruling, the IRS determined that the requirements of Treas. Reg. § 301.9100-3 for granting an extension of time to make an election were met. Under this regulation, an extension of time will be granted if a taxpayer is deemed to have acted reasonably and in good faith. A taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional, including a tax professional employed by the taxpayer if the tax professional failed to make or advise the taxpayer to make the election. In 2018, the standard fee for a letter ruling requiring an extension of time under Treas. Reg. § 301.9100-3 is $10,000. Revenue Procedure 2018-1, 2018-1 IRB 1.

MARITAL DEDUCTION

8. Letter Ruling 201751005 (Issued September 18, 2017; Released December 22, 2017)

IRS grants extension of time to make QTIP election

The decedent, upon his death, provided that his estate would be divided into a bypass trust, a marital trust, and a survivor's trust. The marital trust qualified for the QTIP marital deduction. The executor of the decedent's estate was a CPA. The executor's accounting firm prepared the Form 706 for the decedent's estate. However, the executor misinterpreted the terms of the trust and failed to make the QTIP election with respect to the marital trust. The executor requested an extension of time under Treas. Reg. §§ 301.9100-1 and 301.9100-3 to make the QTIP election to treat the marital trust as QTIP property.

The IRS granted the request for an extension of time to make the QTIP marital deduction election. Treas. Reg. § 301.9100-3 provides that an extension of time will be granted when the taxpayer shows that the taxpayer acted reasonably and in good faith and that granting relief will not prejudice the interests of the government. A taxpayer is deemed to have acted reasonably

and in good faith if the taxpayer reasonably relied on a qualified tax professional and the tax professional failed to make the election or failed to advise the taxpayer to make the election. One question not addressed in this letter ruling is that the executor was a CPA himself or herself and therefore might be considered a qualified tax professional, although his or her area of expertise may not have been estate, gift, and generation-skipping taxes.

GIFTS

9. Karen S. True v. Commissioner, Tax Court Docket No. 21896-16 and H. A. True III v. Commissioner, Tax Court Docket No. 21897-16 (Petitions filed October 11, 2016)

IRS attacks use of Wandry clause in gift and sale of interests in a family business

In the True v. Commissioner case, Husband gave interests in a family business to one of his daughters. At the same time, he sold interests in the family business to his three children and a trust. Husband obtained appraisals from FMV which the court noted is a recognized and reputable national appraisal firm. Since Husband and Wife split the gift, any gift was considered made one-half by each spouse.

When the gifts of the interests in the family business were made to the daughter, the transfer agreement provided that if the value of the interests transferred to the daughter were determined to be worth more than $34,044,838 for federal gift tax purposes, then the interests owned by the daughter would be adjusted so that the value of the gift remained at $34,044,838 and the daughter would be treated as having purchased the ownership interests that were removed from the gift. Thus, the transfer documents utilized adjustment provisions to fix the value of the interests given to the daughter at a specific dollar value similar to the adjustment clause upheld by the Tax Court in Wandry v. Commissioner, T.C. Memo 2012-88 and with which decision the Service disagrees.

With respect to the interests that were sold to that daughter and the other two children and a trust, the transfer documents provided that if the interests sold were undervalued by FMV for federal gift tax purposes, the purchase price would be increased to reflect the fair market value as finally determined for gift tax purposes.

The IRS has alleged a gift tax deficiency of $16,591,418 by each of Husband and Wife. Husband and Wife have countered that the valuations are correct. However, if the transferred interests are determined to have a higher value, no gift should result because of the adjustment provisions contained in the transfer agreement. These two cases may help determine the future validity and usefulness of Wandry adjustment clauses.

10. Letter Ruling 201803003 (Issued October 6, 2017; Released January 9, 2018)

Proposed trust modifications will not trigger gift or generation-skipping tax

An irrevocable trust was created prior to October 22, 1942 by parents for the benefit of Daughter. The Daughter's only right was to receive distributions of net earnings, but not principal, awarded to her by the trustee with the consent of the advisory board of the trust and to distribution of the trust estate made by the trustee at the termination of the trust. At Daughter's death, her equitable interest was to pass to and vest in her heirs in accordance with the laws of descent and distribution then in force. The trust was to continue for Daughter's life and for a period of 21 years after her death at which time the trust would terminate and the trust corpus would be distributed to the beneficiaries.

Because of a planned disclaimer, certain of the children and grandchildren of Daughter had sought a declaratory judgment concerning the impact of their planned disclaimers. The court ruled that Daughter and the successor beneficiaries all had a testamentary general power of appointment. A pre October 22, 1942 power of appointment only has adverse estate tax consequences if it is exercised. Upon the death of Daughter or successor beneficiary, the heirs at law of that beneficiary would succeed to the beneficiary's interest in the trust. The court also ruled that after Daughter's death, each successor beneficiary would have three separate beneficial interests:

A. An income interest for 21 years after Daughter's death;

B. The remainder interest which vested in possession 21 years after Daughter's death; and

C. A pre-1942 general power of appointment.

The court ruled that each of those interests could be disclaimed independently of others.

Several years later, Daughter proposed to partially release her general power of appointment to restrict the power in two respects. First, the power was to be exercisable only in favor of the Daughter's estate. Second, the power could only be appointed to take effect after her death. The intention of Daughter was to allow her power of appointment over the trust to lapse at her death.

Subsequently, the trustee petitioned the supervising court, with the consent of the Daughter and other beneficiaries, to provide that when the trust terminated 21 years after the death of Daughter, any share distributed to a beneficiary under a specified age was to be held in a continuing trust until that beneficiary reached the specified age. If that beneficiary survived Daughter but died before reaching the specified age, the beneficiary would have a general testamentary power of appointment causing the property to be included in the beneficiary's estate. The later petition also requested the court to modify the trust to allow for the administration of the separate trusts created after the Daughter's death.

The taxpayer requested the following rulings:

A. The power of appointment granted to the great grandchildren who succeeded to the Daughter's interest in the trust would be considered a pre-October 22, 1942 power of appointment and the complete release or lapse of that power of appointment would not have any adverse estate, gift, or GST tax purposes.

B. The proposed disclaimer by any one or more of the great grandchildren would be a qualified disclaimer under Section 2518 and would not have any adverse gift tax or estate tax consequences to the disclaimants and would not result in the loss of the GST exempt status of the trust.

C. The assets of a continuing trust created pursuant to proposed modification after Daughter's death would be included in the estate of the beneficiary if the beneficiary died before the termination of the continuing trust.

D. The proposed construction of the trust would not cause the trust to be subject to GST tax.

E. The proposed construction of the trust would not result in a taxable gift by any of the beneficiaries of the trust.

With respect to the first ruling request, the Daughter had a pre-October 22, 1942 general power of appointment to which the grandchildren would succeed when the Daughter dies. To the extent that any grandchild disclaimed his or her interest in that power of appointment or died during the 21 year period following Daughter's death, some great grandchildren might succeed to her power of appointment. Based on the regulations to Section 2041, the power of appointment held by the great grandchildren and more remote beneficiaries would be considered a power created before October 22, 1942 and consequently the release or lapse of such a power would not treated as the exercise of the power and would have no adverse estate or gift tax consequences.

With respect to the second ruling request, Daughter's heirs cannot succeed to any interest in the trust until Daughter's death pursuant to the terms of the trust. Consequently, Daughter's great grandchildren could disclaim their interest and there would be no adverse estate or gift tax consequences.

With respect to the third and fourth ruling requests, the proposed modifications would not have any adverse generation-skipping tax consequences. The modification would fall within the scope of Treas. Reg. 26.2601-1(b)(4)(i)(D)(1) which provides that a modification of the governing instrument of an exempt trust is valid under applicable state law and will not have adverse GST consequences when the modification does not shift a beneficial interest to any beneficiary who occupies a lower generation than the person or persons who held the beneficial interest prior to the modification and the modification does not extend the time for the vesting of any beneficial interest in the trust beyond the period provided for in the original trust. That was the case here.

With respect to the fifth ruling request, because the proposed construction of the trust clarified ambiguous terms of the trust and reflected the rights of the party under applicable law, the proposed construction of the trust would not result in a taxable gift by any of the beneficiaries of the trust.

11. **Letter Ruling 201808002 (Issued November 16, 2017; Released February 23, 2018)**

Service rules on gift tax consequences of gift of life estate interest in pre-October 9, 1990 transaction

Prior to the enactment of Chapter 14 in 1990, husband, wife, and their six children purchased real estate from an unrelated party for the property's fair market value. Husband, wife, and each of the children executed an agreement whereby husband, wife, and each of the children paid the actuarial value of their respective interests from their own resources and none of the six children used any funds acquired from their parents to acquire their respective interests. Under the agreement, wife acquired a life interest in the use of and income from the real property, husband acquired a life interest in the use of and income from the real property that became effective upon the death of the wife, and each of the children had a 1/6th undivided interest in the remainder.

The life tenants wished to give a geographically defined portion of the acreage of their life interest in the real property to the children. As a result, the six children would become the outright owners of that geographically defined real estate.

The taxpayers requested rulings that:

A. The remaining acreage of the real property after the transaction would continue to be treated as resulting from a pre-October 9, 1990 transfer for purposes of the application of Chapter 14.

B. The proposed gifts by the life tenants would be treated as gifts for federal gift tax purposes.

The proposed gifts by the life tenants would not result in any portion of the real property being included in the gross estate of either life tenant for estate tax purposes.

The Service first ruled that the conveyance of the real estate by the life tenants would be treated as gifts for federal gift tax purposes and that the gifts would be valued using the actuarial value of the individual life estate interests determined by the application of the appropriate Section 7520 rate. In addition, the life tenants would not be considered to retain any interest in, or any right to alter or revoke, or any reversion in the portion of the real estate that was conveyed to the remainder beneficiaries and that the transaction would not result in any adverse estate tax consequences to wife and husband. The Service held that the transaction would not be subject to the application of Chapter 14.

12. Letter Ruling 201825003 (Issued March 9, 2018; Released June 22, 2018)

Transfer of the legal title, naked ownership, and remainder interest in and to artwork as defined by the deed of transfer is a completed gift for gift tax purposes

Taxpayer and spouse owned an art collection. The taxpayer as a result of the spouse's death, became the sole owner of the artwork. Prior to the spouse's death, the taxpayer and the spouse entered into a deed of transfer with two museums outside of the United States under which they agreed to donate the artwork with the possession of the artwork by the museums to occur on the death of the second to die and spouse.

The deed of transfer provided that the taxpayers granted to the museums the legal title, naked ownership and remainder interest in and to the artwork. It also provided that the taxpayer expressly reserved a life interest and usufruct in and to the artwork which would automatically expire on the death of the taxpayers.

The deed provided the parties intended for the transfer not to qualify for gift tax purposes on the basis that the taxpayer was not releasing dominion and control over the artwork until death. If the taxpayer received a favorable ruling from the IRS of the gift tax treatment, the donation is deemed to take effect as of the day of the favorable ruling. Certain conditions were imposed in the deed of transfer. The museums were to comply with the requirements regarding the housing, display, and exhibition of the artwork. The museums must not become privately owned and the tax laws must not change to cause the taxpayer to become subject to taxation in the country, during the taxpayer's life or upon death, in connection with the transfer of the artwork if the artwork was to be transferred to museums in a country other than the United States.

The IRS stated that upon the effective date of the deed of trust, the taxpayer would transfer legal title, naked ownership and the remainder interests of the artwork to the museums. During the period of the life interest and usufruct, the taxpayer would not sell or otherwise dispose of any of the artwork. The taxpayer retained no power to change the disposition of the artwork and was barred from doing so under the deed of trust. Even though the transfer of the artwork was subject to several conditions subsequent, the conditions that would cause a revocation of the transfer were not dependent on any act of the taxpayer. Consequently, the taxpayer's grant to the museums of the legal title, naked ownership, and remainder interest to the artwork would be a completed gift for gift tax purposes.

13. Letter Ruling 201836006 (Issued May 30, 2018; Released September 7, 2018)

Service rules on consequences of incomplete non-grantor trust

This letter ruling is one of the most recent letter rulings on the tax consequences of an incomplete non-grantor trust. In this letter ruling, grantor created an irrevocable trust. The beneficiaries were a class consisting of the grantor, the grantor's parents, the grantor's siblings, the grantor's nephew and niece, any issue of the grantor born or adopted after a specified date

and any mutual issue of grantor's parents born or adopted after a specified date. A corporate trustee was the sole trustee of the trust.

The trust provided for a distribution committee consisting of the parents and the two siblings. The distribution committee had the power to appoint income and principal of the trust in a non-fiduciary capacity to one or more beneficiaries by unanimous vote (unanimous member power) and to appoint principal and income in a non-fiduciary capacity to one or more beneficiaries by a majority vote with the affirmative consent of the grantor (grantor's consent power). If no members of the distribution committee were then serving, the trustee could distribute income and principal on a discretionary basis for health, education, maintenance and support. An independent trustee could distribute income and principal in its sole and absolute discretion for any purpose.

The grantor in a non-fiduciary capacity could direct the trustee to distribute principal of the trust to or among the beneficiaries other than the grantor for health, education, support and maintenance (grantor's sole power).

The grantor had a broad limited testamentary power of appointment over the property and the trust. To the extent that the grantor did not exercise the broad limited testamentary power of appointment, the property was to pass to grantor's children, otherwise, to his parents and their descendants.

The following rulings were requested:

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

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

3. Any appointment of trust property by the distribution committee to grantor would not be a completed gift by any member of the distribution committee.

4. Any appointment of trust property by the distribution committee to any beneficiary of the trust other than the grantor would not be a completed gift subject to federal gift tax by any member of the distribution committee.

5. No member of the distribution committee would be considered to have a Section 2041 general power of appointment over any property held in the trust.

The Service first ruled that none of the provisions of the trust would cause the grantor to be treated as the owner of the trust for income tax purposes as long as the distribution committee remained in existence and was serving under any of Sections 673, 674, 676, or 677. The Service then concluded that an examination of the trust revealed none of the circumstances that would cause administrative controls to be considered exercisable primarily for the benefit of the grantor under Section 675. A determination of whether Section 675 would cause the grantor to be

treated as the owner of any portion of the trust for income tax purposes was deferred until the federal income tax returns of the parties were examined.

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

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

ESTATE INCLUSION

14. CCA 201745012 (Issued August 4, 2017; Released November 9, 2017)

Purchase of remainder interest in transferred property in which donor retained annuity, which purchase occurred on donor's deathbed during the term of the annuity, failed to replenish donor's taxable estate, and failed to constitute adequate and full consideration for gift tax purposes

Donor formed Trust 1, which was an irrevocable discretionary trust for the benefit of Donor's first spouse and issue. Trust 1 terminated on the later of the death of Donor or his first spouse, at which time the principal and any accumulated income were distributed outright to Donor's issue. Donor's first spouse predeceased him, and Donor then married second spouse. Later, Donor formed Trust 2, an irrevocable trust for the benefit of Donor and his issue. Under the terms of Trust 2, an annuity is payable to Donor for the term of the trust, and then the remainder is payable to his issue under the terms of Trust 1. Subsequently, Donor formed Trust 3, which had the same terms and provisions as Trust 2.

On what the Service described as Donor's "deathbed," Donor purchased the remainder interest in Trusts 2 and 3 from the trustees of Trust 1. Donor paid the purchase price with two unsecured promissory notes and died the following day.

Donor's estate reported the purchases of the remainder interest as non-gift transfers, asserting that Donor received adequate and full consideration in money or money's worth in the form of the remainder interest in Trusts 2 and 3.

The IRS ruled that where the purchase of the remainder occurs on Donor's deathbed during the term of the annuity, the remainder does not "replenish" the Donor's taxable estate. Consequently, the remainder does not constitute adequate and full consideration in money or money's worth for gift tax purposes pursuant to Merrill v. Fahs, 324 U.S. 308 (1945).

A companion Supreme Court case, Commissioner v. Wemyss, 324 U.S. 303 (1945), stands 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. For example, B's relinquishment of marital rights in A's property will have no effect on the includable value of that property in A's gross estate. For that reason, the relinquishment of marital rights cannot replenish a donor's gross estate for estate tax purposes.

This memo noted that the relinquishment of marital rights did constitute valuable contractual consideration in the hands of Donor and did benefit Donor. This did not have the same effect for gift tax purposes. The Service noted that while Donor's liability on the promissory notes depleted Donor's taxable estate, that does not matter for tax purposes. The purchase of the remainder interest in transferred property in which Donor has retained a Section 2036 "string" over the received remainder does not increase the value of Donor's taxable estate because the value of the entire property, including that of the remainder, is includable in Donor's gross estate.

The IRS also ruled that a note given in exchange for property 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.

15. **Badgley v. United States, _____ F.Supp.3d _____ (N.D. Cal 2018)**

The assets of a GRAT are included in the settlor's estate

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

Patricia died on November 2, 2012 having received her last annuity payment from the GRAT on September 30, 2012, two months before the expiration of the annuity term.

The federal estate tax return reported a gross estate of $36,829,057, including the value of the assets held in the GRAT. The estate paid federal estate taxes of $11,187,457. On May 16, 2016 the estate filed a claim of refund seeking $3,810,004 in estate tax overpaid by the estate as a result of the inclusion of the full value of the GRAT. The case was before the court on cross-motions for summary judgment from the government and the estate.

The estate moved for summary judgment on two bases, asserting that Section 2036(a)(1) did not apply to Patricia's GRAT and that Treas. Reg. § 20.2036-1(c)(2) was overly broad and invalid to the extent that it applied to the GRAT and that the transfer of property the GRAT was a bona fide sale for full and adequate consideration and Section 2036 did not apply to cause inclusion of the property in the GRAT in the estate. The government moved for summary judgment on the

opposite grounds. The estate argued that a "fixed-term annuity" was not the same as a right to income or some other form of possession or enjoyment as required by Section 2036(a)(1). However, the government relied on three cases that took a broad approach to the operative language of Section 2036 and its predecessor: C. I. R. v. Church's Estate; 335 U.S. 632 (1939); Spiegel's Estate v. Commissioner, 335 U.S. 701 (1949); and Helvering v. Hallock, 309 U.S. 106 (1940). The court found that Section 2036 applied to the GRAT. Although plaintiff was correct that the government's authorities did not expressly equate a fixed-term annuity with a right to income or some other possession or enjoyment, the Supreme Court had adopted a substance over form approach that favored a finding that the annuity comprised some form of possession, enjoyment, or right to income from the transferred property.

Treas. Reg. 20.2036-1(c)(2)(i) requires that transferred GRAT property be included in a decedent's gross estate where the decedent retains an annuity interest and dies before the expiration of the annuity term. The court found that the regulation was valid even though Section 2036 does not equate "income" with a fixed term annuity in Section 2036. The silence did not mean that the interpretation of the Section is arbitrary or capricious. Instead the regulation is a permissible interpretation of Section 2036. The court also rejected the argument that the regulation was arbitrary because it would result in the inclusion of all private annuities in the decedent's gross estate and was overly broad to the extent that the regulations subsequently included GRATs such as Patricia's that "have no ordering rule, do not provide for income payments disguised as annuity payments, and at the time of grantor's death can satisfy the annuity payments entirely out of principal." The second argument failed once the court rejected the attempted distinction between an annuity and a right to income.

The court also rejected the argument that the creation of the GRAT was property transferred to the GRAT in a bona fide sale in exchange for an annuity. The court noted that the funding of the GRAT does not involve selling the transferred property to a third party in exchange for an annuity. There is no other owner of property engaging in the sale transaction other than the transferor.

Finally, the formula used to determine the included value of the GRAT was reasonable even though it assumed that the annuity was paid solely from income. The estate argued that an annuity can, in fact, be paid from either principal or income and thus the formula yielded a capriciously large amount to be included for tax.

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

VALUATION

16. Letter Ruling 201819010 (Issued February 8, 2018; Released May 11, 2018)

IRS grants extension of time to make Section 754 election

A general partnership was organized under state law. A and B owned a percentage interest in the partnership as community property. B died. The executor intended to make an election under

Section 754 in connection with the death of B to step up the basis of partnership property. However, the executor failed to file a timely return to make the election. The executor represented that it had acted reasonably and in good faith and that granting the relief would not prejudice the interests of the government.

Treas. Reg. § 1.754-1(b)(1) provides that an election under Section 754 to adjust the basis of partnership property is to be made in a written statement filed with a partnership return for the taxable year in which the distribution or transfer occurs. For the election to be valid, the return must be filed not later than the time prescribed for filing the return for the taxable year. Under Treas. Reg. §§ 301.9100-1 and 301.9100-3, a request for an extension of time to make an election will be granted when a taxpayer provides evidence to establish that the taxpayer acted reasonably and in good faith and that the grant of the relief will not prejudice the interests of the government. In this situation, the Service found that the requirements of Treas. Reg. §§ 301.9100-1 and 301.9100-3 were satisfied and granted an extension of time to make the Section 754 election

17. **Letter Ruling 201814004 (Issued December 11, 2017; Released April 6, 2018)**

IRS allows extension of time to make special use valuation election for farmland

Upon decedent's death, son and daughter were co-trustees of her revocable trust and co-executors of her estate which included farmland. Son and daughter retained an accountant to prepare and file the Form 706. The accountant failed to advise son and daughter to make the Section 2032A special use valuation election for the farmland. The son and daughter timely filed the Form 706.

After filing the Form 706, the son met with an attorney to discuss estate planning. The attorney discovered that the special use valuation election was never made on the Form 706. As a result of this discovery, the estate requested an extension of time to make the special use valuation election.

Under Treas. Reg. §§ 301.9100-1 and 301.9100-3, an extension of time to make an election will be granted if the IRS determines that the taxpayer acted reasonably and in good faith and that granting the relief will not prejudice the interests of the government. The taxpayer is deemed to have acted reasonably and in good faith if the taxpayer relied on a qualified tax professional and the tax professional failed to advise the taxpayer to make the election.

The Service ruled that the requirements of Treas. Reg. §§ 301.9100-1 and 301.9100-3 had been satisfied and an extension of time to make the special use valuation election was granted.

18. Letter Ruling 201820010 (Issued February 13, 2018; Released May 18, 2018)

IRS allows extension of time for estate to elect alternate valuation date

The executor of decedent's estate consulted an attorney to prepare the Form 706. The Form 706 was timely filed however, the attorney failed to make the alternate valuation election under Section 2032 on the initial Form 706. The executor now requested an extension of time to make the alternate valuation election and use the alternate valuation method in reporting the value of the gross estate on the return.

Under Treas. Reg. §§ 301.9100-1(c) and 301.9100-3, the IRS may grant an extension of time if the taxpayer shows that the taxpayer acted reasonably and in good faith and that the granting of relief will not prejudice the interests of the government. A taxpayer is deemed to have acted reasonably and in good faith if the taxpayer failed to make the election because, after exercising reasonable diligence (taking into account the taxpayer's experience and the complexity of the return or issue), the taxpayer was unaware of the necessity for the election.

The IRS ruled that the requirements of regulations had been satisfied and granted an extension of time to make the alternate valuation election.

19. Letter Ruling 201815001 (Issued December 11, 2017; Released April 13, 2018)

IRS allows extension to elect alternate valuation date

Upon decedent's death, the executor of the estate consulted CPA to prepare the Form 706 which was timely filed. CPA failed to make the alternate valuation election under Section 2032 on the Form 706. The CPA stated in an affidavit that he intended to make the alternate valuation election, but failed to check the box. The executor requested an extension of time to make the alternate valuation method election.

Under Treas. Reg. §§ 301.9100-1 and 301.9100-3, a reasonable extension of time may be granted if the taxpayer proves that the taxpayer acted reasonably and in good faith and the granting of relief will not prejudice the interests of the government. The taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional, including a tax professional employed by the taxpayer, and the tax professional failed to make the election.

The Service ruled that the requirements of the regulations had been satisfied and granted an extension of time to make the alternate valuation date election.

20. Letter Ruling 201825013 (Issued March 19, 2018; Released June 22, 2018)

IRS grants an extension of time to make the alternate valuation election

After decedent's death, the co-executors hired an attorney to prepare the estate tax return. The attorney prepared the estate tax return but failed to make the alternate valuation date election. The estate tax return was timely filed. Subsequently, after the due date of the estate tax return, the co-executors filed a supplemental estate tax return making the Section 2032 election. The Service then issued a letter to the estate stating that since the alternate valuation election was not made timely, the assets could only be valued using the alternate valuation date if an extension of time was granted under the relief provisions of Treas. Reg. §§ 301.9100-1 and 301-9100-3.

In this letter ruling, the IRS concluded that the standard of those treasury regulations were satisfied. Treas. Reg. § 301.9100-3 states that an extension of time for that relief will be granted if the taxpayer provides evidence to show that the taxpayer acted reasonably and in good faith and that granting the relief will not prejudice the interests of the government. A taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional.

21. Estate of Clara M. Morrissette v. Commissioner, Tax Court Order, Docket No. 4414-14 (June 21, 2018)

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

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

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

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

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

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

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

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

In each of 2006 through 2009, Clara Morrissette reported gifts to the dynasty trusts under the economic benefit regime of the cost of the current life insurance protection determined under Table 2001 less the amount of the premiums paid by the dynasty trusts. Clara Morrissette died

on September 25, 2009 and was survived by her three sons. After Mrs. Morrissette's death, the estate retained Valuation Services, Inc. to value the receivables included in the gross estate as of the date of her death. Valuation Services, Inc. valued the receivables at $7,479,000.

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

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

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

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

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

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

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

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

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

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

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

Richard was the settlor of a revocable trust called the Survivor Trust. Patrick was the trustee of the Survivor Trust and was also decedent's attorney-in-fact under a California Power of Attorney. Richard's involvement in the three split dollar life insurance arrangements was effected solely through the Survivor Trust and was directed by Patrick Cahill either as decedent's attorney in fact or as trustee of Survivor Trust. The parties agreed that everything in the Survivor Trust on decedent's date of death was included in the decedent's gross estate. Decedent was also settlor of the Morrison Brown ("MB") Trust which was created in September 2010 by Patrick

Cahill as decedent's agent. William Cahill was trustee of the MB Trust and the primary beneficiaries of the MB Trust were Patrick and his issue. The MB Trust owned three whole life insurance policies. Two policies were on the life of Shannon Cahill, Patrick Cahill's wife, and one policy was on the life of Patrick Cahill. The policy premiums were paid in lump sums as shown in the chart below.

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

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

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

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

The court also reviewed the argument of the government that Section 2703 would apply to the MB Trust's ability to veto termination of split-dollar arrangements. It found that split dollar

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

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

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

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

23. **Streightoff v. Commissioner, T.C. Memo 2018 - 178**

Court accepts government's valuation of limited partnership interests in decedent's estate

Decedent, Frank Streightoff, was a resident of Texas when he died in 2011. During decedent's lifetime, his daughter, Elizabeth Streightoff, held the decedent's power of attorney.

On October 1, 2008, decedent through Elizabeth Streightoff, formed Streightoff Investments LP as a Texas Limited Partnership. Streightoff Investments during decedent's life did not hold meetings or have votes.

The partnership agreement stated that the purpose of Streightoff Investments was to make a profit, increase wealth, and provide a means for decedent's family to manage and preserve family assets.

Decedent funded Streightoff Investments with marketable securities, municipal bonds, mutual fund investments, other investments, and cash. As of January 31, 2009, 61.6 percent of Streightoff Investments ‘assets consisted of marketable securities, 23.6 percent consisted of fixed income investments in municipal bonds, and 13.3 percent was invested in mutual funds.

Streightoff Management LLC was the sole general partner of Streightoff Investments. Elizabeth Streightoff was the manager of Streightoff Management. The Streightoff Investments partnership agreement provided that the general partner was in charge of conducting the business of the partnership. Decedent, his daughters, his sons and his former daughter-in-law were the original limited partners under the partnership agreement. The limited partners other than decedent received their limited partnership interest as gifts. Upon formation, decedent and the other partners had the following interests:

Partner	Percentage	Type
Streightoff Investments	1.00%	General
Decedent	88.99%	Limited
Elizabeth Streightoff	1.54%	Limited
Ann Fennell Brace	1.54%	Limited
Camille Schuma	1.54%	Limited
Jennifer Ketchurn Hodges	1.54%	Limited
Hilary Dan Billingalea	1.54%	Limited
Charles Franklin Streightoff	1.54%	Limited
Frank Hatch Streightoff	1.54%	Limited
Priscilla Streightoff	1.54%	Limited

Section 7.2 of the partnership agreement provided that a limited partner could not sell or assign an interest in Streightoff Investments without obtaining the written approval of the general partner, which approval would not be unreasonably withheld. Any partner who assigned his or her interest remained liable to the partnership for promised contributions or excessive distributions unless and until the assignee was admitted as a substitute limited partner.

On October 1, 2008, the same day that the decedent formed Streightoff Investments, he established the Frank D. Streightoff Revocable Living Trust and transferred his 88.99 percent interest in Streightoff Investments to the Revocable Trust. Frank Streightoff was the sole beneficiary and Elizabeth Streightoff was the trustee of the revocable trust. On October 1, 2008, decedent, through Elizabeth Streightoff executed an assignment of interest which designated the decedent as assignor and the revocable trust as assignee of the limited partnerships interests. Elizabeth Streightoff signed the transfer agreement in her capacities as the holder of the decedent's power of attorney, trustee of the revocable trust, and managing member of Streightoff Management.

After decedent's death in 2011, on decedent's federal estate tax return, Elizabeth Streightoff, as executor, elected the alternate valuation date. The net asset value of the 88.99 percent assets in the partnership on the alternate valuation date was $7,307,951. The estate used a combined 37.2

percent discount for lack of marketability, lack of control, and lack of liquidity, and reported the value of the limited partnerships interest as $4,588,000.

The court first had to determine whether the interest transferred to the revocable trust was a limited partnership interest or assignee interest. It noted that the federal tax effect of particular transactions is governed by the substance of the transaction rather than its form. The court concluded that the decedent transferred a limited partnership interest to the revocable trust and not an assignee interest. The economic realities underlying the decedent's interest also support the court's conclusion that the transferred interests should be treated as limited partnership interests for estate tax purposes. That was because, regardless of whether an assignee or limited partnership interest had been transferred, there would have been no substantial difference before or after the transfer of the limited partnership interests to the revocable trust. Also, even though an assignee could not vote, the partnership held no votes before decedent's death.

The court then looked at the appropriate valuation of the limited partnership interests. The IRS used Juliana Vicelya and the estate used Howard Frazier Barker Elliot (HFBE). The court first determined that there was no discount for lack of control since the interest transferred was an 88.99 percent limited partnership interest which could control the partnership. It noted that limited partners with a 75 percent interest could remove general partners and a general partner's removal terminated the partnership. This gave decedent's interest control over the partnerships.

HFBE valued the interest as an assignee interest and concluded that a 13.4 percent discount for lack of control should be applied. Since the court determined that a limited partnership interest and not an assignee interest was transferred, a discount for lack of control was not appropriate. The IRS's appraiser determined that an 18 percent discount for lack of marketability was appropriate. This was based on the highly liquid nature of the underlying assets of the partnership. In addition, the diversification of the underlying assets would make an interest in the partnership attractive to a hypothetical buyer, and the amount of control provided to an 88.99 percent limited partnership interest was a factor favoring a lower discount. Finally, the right of first refusal in the partnership agreement warranted a lower discount. HFBE concluded that a 27.5 percent discount for lack of a marketability was appropriate. However, one HFBE appraiser testified that his analysis of the lack of marketability discount would have included different considerations if the interest was a limited partnership interest with voting rights under the partnership agreement, as the court determined. Consequently, the court determined that the interest should be valued using an 18 percent discount rate for lack of marketability as the IRS' appraiser proposed.

24. **Estate of Turner v. Commissioner, 151 T.C. No. 10 (2018) (Turner III)**

Tax Court addresses tax issues arising from inclusion of family limited partnership interests in estate of first spouse to die

In April 2002, Clyde W. Turner, Sr. ("Clyde Sr.) and his wife Jewell formed a limited partnership, each transferred $4,333,671 in cash, CDs, and publicly-traded securities to the partnership, and each took back a 0.5% general partner interest and a 49.5% limited partner

interest. On December 31, 2002, and January 1, 2003, they gave limited partner interests to children and grandchildren and an irrevocable trust for one child. Clyde Sr. became seriously ill and was hospitalized in October 2003 and died on February 4, 2004.

In Estate of Turner v. Commissioner, T.C. Memo. 2011-209 (Aug. 30, 2011) (Turner I), the Tax Court (Judge Marvel) rejected Clyde Sr.'s executor's claims of nontax purposes of asset management and protection and resolution of family disputes, viewed the creation of the partnership as "a part of a testamentary plan" in which Clyde Sr. retained both enjoyment and control, and thus found that the value of the assets he had transferred to the partnership was included in his gross estate under Section 2036(a)(1) and (2).

In Estate of Turner v. Commissioner, 138 T.C. 306 (March 29, 2012) (Turner II), the executor returned to the court to seek reconsideration of its 2011 decision, which the court denied, and to claim in the alternative that a reduce-to-zero pecuniary bequest nevertheless protected the estate from estate tax by providing an increased marital deduction. The court held, in effect, that even though the value of the assets was pulled back into the gross estate, the transferred assets were out of Clyde Sr.'s control and therefore could not pass to Jewell or qualify for a marital deduction.

As clarified in Turner III, the result of Turner II was that "the only taxable portion of the estate is the portion attributable to the Section 2036 inclusion" (implying, although not explicitly saying, that the entire estate still within Clyde Sr.'s control and therefore disposable at his death was allocated to the marital bequest). Therefore, in the calculation of the estate tax liability following Turner II, the IRS asserted in Turner III that "the estate must reduce the marital deduction by the amounts of Federal estate and State death taxes the estate must pay because the only property available to fund the payments is property that would otherwise pass to Jewell and qualify for the marital deduction."

In Turner III, the court rejected the IRS' argument and held that the original marital deduction is still preserved because any payment by the executor out of assets allocated to the marital bequest (which were the only assets left) would entitle the executor to recovery under Section 2207B(a), which provides:

"(1) In general.—If any part of the gross estate on which tax has been paid consists of the value of property included in the gross estate by reason of Section 2036 (relating to transfers with retained life estate), the decedent's estate shall be entitled to recover from the person receiving the property the amount which bears the same ratio to the total tax under this chapter which has been paid as—

"(A) the value of such property, bears to

"(B) the taxable estate.

"(2) Decedent may otherwise direct.—Paragraph (1) shall not apply with respect to any property to the extent that the decedent in his will (or a revocable trust) specifically indicates an intent to waive any right of recovery under this subchapter with respect to such property."

The court noted (at p. 14) that Clyde Sr.'s will did not address the payment of taxes or their apportionment, which the court found "not surprising because Clyde Sr. did not know that the Court would apply Section 2036 to his lifetime transfers." The court also noted, however, that Clyde Sr.'s will "clearly manifests his intention that the marital deduction not be reduced or diminished by the estate's tax liabilities." (In fact, the reduce-to-zero marital bequest, quoted in Turner II, includes the phrase "undiminished by any estate, inheritance, succession, death or similar taxes.") The court concluded:

"Accordingly, we hold that the estate need not reduce the marital deduction by the amount of Federal estate and State death taxes it must pay because the tax liabilities are attributable to the Section 2036 assets, the estate has the right to recover the amount paid under Section 2207B, and the estate must exercise that right to recover to give effect to Clyde Sr.'s intention that Jewell receive her share of the estate undiminished by the estate's tax obligations."

The court also rejected the executor's contention that the marital deduction should be increased by the amount of income generated after Clyde Sr.'s death by assets attributable to the marital share.

Turner III is not especially interesting because it tells us rules of law we did not know about. It is interesting because of the peculiar and questionable way in which it applies the rules we do know, and the implications we now see these rules might have beyond their customary context.

First, Turner I provided that the value of the assets Clyde Sr. transferred to the partnership in April 2002 was included in his gross estate, not the value of the gifts of partnership interests he made on December 31, 2002, and January 1, 2003. Who then is "the person receiving the property" from whom Section 2207B(a)(1) gives his executor a right of recovery? Is it not the partnership? If so, how is recovery obtained? And would not recovery from the partnership reduce the value of all interests in the partnership, including, after all, Jewell's interests? Or was the "transfer" contemplated by Section 2207B(a)(1) not complete until and to the extent of Clyde Sr.'s gifts, so the recovery, if it comes from the partnership, must somehow come from the partnership interests of those transferees? Would not that be contrary to the recent application of Section 2036 in family limited partnership cases even to the assets represented by the partnership interests the partner retains until death?

Second, the recovery Turner III apparently contemplates, as quoted above, is "the amount of *Federal estate and State death taxes* [the estate] must pay because the tax liabilities are attributable to the Section 2036 assets" (emphasis added). In fact, the opinion uses the phrase "Federal estate and State death taxes" ten other times, including as the heading for its discussion of the right of recovery. But Section 2207B says nothing about state taxes. Clyde Sr. died domiciled in Georgia, a state with an estate tax coupled with the federal credit for state death

taxes, and he died in 2004, when the federal state death tax credit had been phased down to 25% but not eliminated.

Third, footnote 2 of Turner III opinion states that Clyde Sr.'s wife Jewell had died on July 8, 2007, and that a related case for her estate (Docket No. 29411-11) was pending in the Tax Court. The petition was filed December 23, 2011, and the IRS's motion of August 3, 2012, for continuance of the trial was granted August 29, 2012, and there are no entries in the docket since August 29, 2012. If Clyde Sr.'s executor does not seek and obtain the recovery contemplated by Section 2207B(a), or if he does anything else in a manner the IRS dislikes, Jewell's estate's pending matter gives the IRS one more setting in which to raise its concerns, for example by asserting that Jewell was deemed to make a gift or her gross estate is enhanced by the full marital deduction Clyde Sr.'s executor eventually takes into account.

Fourth, if every lifetime transfer potentially subject to Section 2036 now carries with it the potential for recovery from the transferee for additional estate taxes that might be paid, who can tell what use could be made of that potential in discounting the value of those transfers even further? A comparison could be made to Steinberg v. Commissioner, 145 T.C. 184 (2015), the "net net gift" case in which the court allowed a reduction in the value of a gift for the actuarially calculated value of the donee's assumption of the obligation to pay the additional estate tax under Section 2035 if the donor died within three years of the gift. The problem is that in *Steinberg* the taxpayer conceded that there would be an increase in the gross estate under Section 2035 if the donor died within three years. It is hard to imagine any donor conceding a Section 2036 inclusion at the time of a transaction like the creation of the partnership in *Turner III*.

Fifth, Clyde Sr. died in February 2004. His executor filed the estate's Tax Court petition in August 2008. There are a total of 82 entries in the Tax Court docket for the estate over the last ten years, although, curiously, none between February 2013 and April 2017. One could ask if this hassle and delay is worth it.

CHARITABLE GIFTS

25. Letter Ruling 201845014 (Issued August 9, 2018; Released November 9, 2018)

IRS issues favorable letter ruling with respect to two charitable remainder unitrusts

X intended to form two charitable remainder unitrusts. CRUT 1 was an inter vivos CRUT with X's life as the measuring life. CRUT 2 was an inter vivos CRUT with consecutive life interests in X and X's spouse, subject to X's right to revoke the spouse's survivor remainder interest. Each CRUT provided that the unitrust amount would be a percentage of the net fair market value of the trust property determined as of the first business day of the taxable year. Each CRUT also provided that the trustee would distribute to the private beneficiary (i) a fixed percentage of the unitrust amount and (ii) such additional portion of the unitrust amount as the independent trustee determined was necessary to ensure that the total portion of the unitrust amount distributed to the private beneficiary in each taxable year was not de minimis under the facts and circumstances (the "minimum amount").

After providing for the distribution of the minimum amount to X or X's spouse, the trustee was to distribute the balance of the unitrust amount to such one or more of the private beneficiaries, and one or more charitable organizations in the "charitable class" as the independent trustee selected in equal or unequal portions in the independent trustee's sole discretion without the approval or consent of any other person. The charitable class, which would contain the permissible charitable distributees, consisted of such of one or more charitable organizations that X, as an individual and not as a fiduciary, designated by an instrument delivered to the independent trustee. The power to designate the members of the charitable class lapsed each year. X also retained the testamentary power to appoint the charitable organizations that would receive the remainder at the end of the unitrust term. A default charity was named to the extent that X did not exercise the testamentary power of appointment.

X retained the power to remove and appoint an independent trustee. When X ceased to act, X's wife was designated as the appointer and remover of the independent trustee.

The IRS was requested to give the following rulings:

1. The power of the independent trustee to allocate a portion of the unitrust amount between noncharitable and charitable beneficiaries would not prevent either CRUT from qualifying as a CRUT under Section 664.

2. The powers of X and X's wife to replace the independent trustee would not prevent either CRUT from qualifying as a qualified CRUT under Section 664.

3. The power of X to designate the charitable class of each trust would not prevent either CRUT from qualifying as a qualified CRUT under Section 664.

4. X's testamentary power to revoke the survivor remainder interest would not prevent CRUT 2 from qualifying as a qualified CRUT under Section 664.

5. X's power to designate the charitable class of each CRUT would prevent completion of the gift of the net unitrust amount during X's lifetime until the annual lapse of such power. Upon the annual lapse of X's power to designate the charitable class and to the extent each year that the net unitrust amount was distributed to one or more charitable organizations, the distributions would be completed gifts that would qualify for the gift tax charitable deduction.

6. X's testamentary power to revoke the survivor remainder interest in CRUT 2 would cause X's gift of the survivor remainder interest to remain incomplete until X's death.

7. With respect to CRUT 2, if X's spouse survived X and if X did not revoke the survivor remainder interest at X's death, the entire value of the assets of CRUT 2 included in X's estate would be deductible because of the combined charitable and marital estate tax deductions.

The Service first ruled that the provisions in each CRUT giving the independent trustee the power to allocate a portion of the unitrust amount between charitable and noncharitable beneficiaries would not prevent either CRUT from qualifying as a valid CRUT under Section 664. The IRS noted that Section 674(c) provides an exception to the general rule of Section 674(a) under which the power of an independent trustee to allocate the unitrust amount among charitable and noncharitable beneficiaries on an annual basis is consistent with the provisions of the Internal Revenue Code governing charitable remainder trusts. The governing instrument must require that a portion of the unitrust amount be allocated and paid to the noncharitable beneficiaries each year and that amount must be not de minimis.

The Service next concluded that the retained powers of X and X's wife to remove and appoint the independent trustee would not allow them to substitute any person who would be subordinate to X or X's wife. Consequently, these powers to remove and replace the independent trustee would not prevent either CRUT from qualifying as a valid CRUT under Section 664.

The Service next ruled that X's power to designate the charitable class of each CRUT would not prevent either CRUT from qualifying as a valid CRUT under Section 664. In addition, X's testamentary power to revoke the survivor remainder in CRUT 2 would not prevent CRUT 2 from qualifying under Section 664.

The Service then ruled that X's annual power to designate the charitable class would prevent completion of the gift of the net unitrust amount of each CRUT during X's lifetime until the lapse of such power. Upon the annual lapse of X's power to designate the charitable class and to the extent each year that the net unitrust amount was distributed to one or more charitable organizations, the distributions would be completed gifts and would qualify for the gift tax charitable deduction. In addition, the retention of the power to revoke the survivor remainder in CRUT 2 would cause X's gift of the survivor remainder to remain incomplete until X's death. At X's death, the property remaining in CRUT 2 would not be subject to estate tax because it would qualify either for the marital deduction or the charitable deduction.

26. **<u>Wendell Falls Development, LLC v. Commissioner</u>, T.C. Memo 2018-45; motion for reconsideration denied, T.C. Memo 2018-193**

No charitable contribution deduction is allowed for the donation of a conservation easement and no penalty is applicable

The IRS disallowed an income tax charitable contribution deduction of $1,798,000 for the contribution of a conservation easement by Wendell Falls LLC. The IRS also sought to impose a 40 percent penalty for a gross valuation misstatement or, in the alternative, a 20 percent penalty for a substantial valuation misstatement. Wendell Falls, as part of a planned unit development in Wake County, North Carolina, intended to develop 1,280 acres. It also identified 125 acres of the 1,280 acres as the land upon which a park would be placed. In late 2006, the Wake County Board of Commissioners authorized the county to buy the 125 acres identified on the map as a park. Because of an incorrect reference in the planned unit development to the park having 160 acres as opposed to 125 acres, the purchase agreement inadvertently stated that the acreage of the planned park was 160 acres. The purchase agreement also stated that placing a mutually

agreeable conservation easement on the land was a precondition to the sale. After realizing the mistake and having a new appraisal done, the land was valued at $3,020,000 unrestricted by any conservation easement and the Wake County Board of Commissioners reauthorized the purchase. On June 7, 2007, a conversation easement on the 125 acres was placed on the property and subsequently a general warranty deed was recorded transferring ownership of the 125 acres from Wendell Falls to Wake County.

On its partnership return for 2007, Wendell Falls claimed a charitable contribution deduction of $1,798,000 for the contribution of the conservation easement. The value of the conservation easement, according to the appraiser, was $4,818,000, and $1,798,000 represented the difference between the appraised value and the price paid by Wake County. The court denied the charitable contribution deduction for the easement for two reasons. The first was that Wendell Falls expected a substantial benefit from the conservation easement. The evidence showed that Wendell Falls would benefit from the increased value in the lots to be sold in the planned unit development from having the park as an amenity. Consequently, Wendell Falls donated the easement with the expectation of receiving a substantial benefit. The court held that the charitable contribution deduction was not allowable because of the expectation of the substantial benefit.

Alternatively, the value of the easement was zero. An easement must have value to generate a charitable contribution deduction. In order to determine the value because there were no sales of easements comparable to the easement contributed by Wendell Falls, the value of the easement would be equal to the value of the land before the easement minus the value of the land after the easement. In looking at the plan developed by Wendell Falls which had owned the entire 1,280 acres including the 125 acres, the best use of the 125 acres was as a park in the midst of a master planned community. The conservation easement did not diminish the value of the 125 acres because it was not prevented from being put to its best use. As a result, the value of the easement was zero.

After trial, the IRS conceded that the 40 percent penalty for gross valuation misstatement did not apply. The court rejected the imposition of the 20 percent penalty because Wendell Falls LLC had acted in good faith since it had hired two different state-certified real estate appraiser to value the conservation easement.

27. <u>Champions Retreat Golf Founders, LLC v. Commissioner</u>, T.C. Memo 2018-146

Golf club development was not entitled to charitable deduction for donation to land trust of conservation easement operating across golf course

Champions Retreat received a 463.3-acre tract to build a golf course in 2002. Champions Retreat raised an initial $13.2 million for construction of the golf club by selling 66 residential lots and borrowing heavily in order to complete construction of the golf club which occurred in June 2005. The golf club accounted for 363.56 acres of the 463.3-acre tract. After completion, Champions Retreat was not profitable. On December 16, 2010, Champions Retreat conveyed an

easement that covered 348.51 acres to North American Land Trust. Champions Retreat claimed a $10,427,435 income tax charitable deduction on its partnership income tax return for 2010.

The easement identified three conservation purposes:

1. Preservation of the area as a relatively natural habitat of fish, wildlife, or plants or similar ecosystems;

2. Preservation of the area as an open space which provided scenic enjoyment to the general public and yielded a significant public benefit; and

3. Preservation of the area as an open space which, if preserved, would advance a clearly delineated federal, state, or local governmental conservation policy and would yield a significant public benefit.

The court observed that the easement area included 25 of the 27 holes in their entirety, most of the two remaining holes, and the driving range.

On audit, the IRS denied the income tax deduction on two alternative grounds. The first was that the conservation easement did not meet the requirements of Section 170. The second was that the easement did not have a value greater than zero.

The court only addressed the first ground advanced by the IRS. The court was unpersuaded that there was a sufficient presence of rare, unchanged, or threatened bird species in the easement area. In addition, the denseflower knotweed, which is a rare, endangered, or threatened species, only occupied a small fraction of the easement area.

Thus, a habitat for rare, endangered, or threatened species of animals, fish, or plants was not provided.

The court also concluded that the easement area was not a natural area that contributed to the ecological viability of the Sumter National Forest, which lies across the Savannah River from the easement area.

The easement area did not meet the test for providing open space because of the limited physical access of the public to view the easement area from the Little and Savannah Rivers which was further limited by three to ten foot river banks.

Finally, Champion Retreats' preservation of open space was neither for the enjoyment of the general public nor pursuant to a clearly delineated government policy. Thus, it could not provide a significant public benefit.

28. **Belair Woods, LLC v. Commissioner, T.C. Memo 2018 - 159**

On cross motions for partial summary judgment, court concludes that Belair did not comply, either strictly or substantially, with the requirements of the regulations with respect to obtaining an income tax charitable deduction; however, disputes of

material fact existed as to whether Belair had reasonable cause for failure to supply a fully completed appraisal summary

This case was decided on cross motions for partial summary judgment. Belair was formed in the late 2008 as a Georgia limited liability company. On December 18, 2008, HRH Investments LLC contributed 145.15 acres of real estate to Belair. On December 30, 2009, Belair entered into a deed of conservation easement with the Georgia Land Trust and the deed was recorded the next day. Belair delegated many details regarding this transaction to Forever Forests, LLC. Forever Forests was a consulting firm specializing in structuring conservation easements to maximize the tax benefits for donors. Forever Forests advised Belair on the terms of easement as well as the tax filings with respect thereto.

Belair timely filed the partnership return and claimed an income tax charitable contribution deduction of $4,778,000 for the donation of the easement. Belair included with the return a copy of an appraisal that relied on the "before and after" method to value the easement. Belair also included with its return a Form 8283 executed by the appraiser and the Georgia Land Trust. The instructions to Form 8283 directed the taxpayer to provide the IRS with certain information regarding non-cash charitable contributions. When a taxpayer donates property (other than publicly traded securities) valued in excess of $5,000, the taxpayer must provide:

1. A description of the donated property;

2. A brief summary of its physical condition;

3. Its appraised fair market value;

4. The date the property was acquired by the donor;

5. The manner of acquisition; and

6. The donor's cost or adjusted basis.

The instructions to the Form 8283 also state that "[I]f you have reasonable cause for not providing the information. . .attach an explanation so your deduction will not automatically be disallowed."

Belair contacted Forever Forests about preparing the Form 8283, specifically with reference to reporting its "cost or adjusted basis," since it was using the "before and after" method to value the easement. Forever Forests relayed advice it had received in 2008 from the Baker Donelson law firm. At the request of Forever Forests, an attorney at that firm had reviewed the instructions to the Form 8283 and concluded that it should not be necessary to include the basis information if an explanation is attached to the Form 8283 providing reasonable cause why the basic information was not included. The attorney also stated that a reasonable cause for not including basis information should be that the basis of the property was not taken into consideration when computing the amount of the deduction.

When it filed the Form 8283, Belair appended a two-page letter which stated that a declaration of the taxpayer's basis in the property was not included because the basis of the property was not taken into consideration in computing the amount of the deduction.

The IRS audited Belair's 2009 return and issued a summary report explaining that Belair's claimed deduction should be disallowed because Belair did not include information concerning the cost of the easement or adjusted basis on the Form 8283. About one month later, Belair's CPA responded to the summary report and provided cost basis information concerning the easement.

On June 19, 2017, the IRS disallowed the deduction because the requirements of Section 170 had not been met. Alternatively, the IRS determined that no kind of deduction was allowable because Belair had not established the fair market value of the easement. The IRS also proposed a 40 percent gross valuation misstatement penalty or, in the alternative, a 20 percent accuracy related penalty. Both Belair and the IRS agreed that Treas. Reg. § 1.170A-13(c)(2)(i)(B) requires a donor to attach a fully completed appraisal summary to the tax return on which the charitable contribution deduction is first claimed. The tax deduction will not be disallowed simply because of the inability (for reasonable cause) to provide certain information.

The Tax Court concluded that Belair did not strictly comply with the regulatory requirements because it did not report its cost basis as the regulation requires and as Form 8283 directed. Moreover, the explanation that Belair attached to that form, far from showing its inability to provide the information, simply asserted that the information was unnecessary. Belair contended that it had reasonable cause for omitting the basis information because it did not know what basis to report. The court noted that even if Belair's premise was correct, the conclusion did not follow from its premise. The regulations exclude the admission of basis information only if a reasonable cause is established and the explanation is attached to the appraisal.

Belair alternatively contended that it cured its initial omission by supplying cost basis information during the audit with the IRS. Treas. Reg. § 1.170A-13 (c)(4)(iv)(H) provides that a deduction will not be disallowed for failure to attach an appraisal summary if the donor complies with IRS instructions to submit that document within 90 days of an IRS request therefor. Belair argued that this regulation entitled it to relief because its CPA provided basis information to the IRS in January 2013 shortly after being notified that Belair's deduction would be denied for failure to submit a properly completed Form 8283. The court said that the regulation did not apply in this situation. Belair did not fail to attach an appraisal summary. Rather Belair intentionally included an incomplete Form 8283 with its return.

The court also rejected Belair's argument that it had substantially complied with the regulation. Relying upon RERI Holdings 1, 149 T.C. ___ (July 3, 2017), the court concluded that a taxpayer did not substantially comply with a reporting requirements when it failed to disclose cost or adjusted basis on the Form 8283. However, Belair contended that when preparing its Form 8283, it reasonably relied on advice from Forever Forests, which in turn relied on advice from an outside law firm. The court concluded that the resolution of this issue could require it to address several questions as to which genuine disputes of material fact currently appeared to exist. These questions included whether Forever Forests was a tax professional, whether Forever Forests was

a competent and independent advisor unburdened with a conflict of interest, whether Belair could reasonably rely on legal advice relayed to it indirectly and whether Belair actually relied in good faith on advice that the IRS seemed to regard as too good to be true. As a result, the court denied Belair's motion for partial summary judgment and granted in part and denied in part the IRS's motion for partial summary judgment.

29. Notice 2017-73, 2017-51 IRB 562 (December 4, 2017)

IRS describes approaches being considered to address certain issues regarding Donor Advised Funds

This notice describes approaches that the Treasury Department and the Internal Revenue Service are considering to address certain issues regarding Donor Advised Funds. Specifically, the Treasury Department and the IRS are considering developing proposed regulations that would provide that certain distributions from a Donor Advised Fund that paid for the purchase of tickets that enable a Donor, Donor advisor, or related person to attend or participate in a charity-sponsored event do not result in more than an incidental benefit to such person. The Treasury Department and the IRS are also considering proposed regulations that distributions from a Donor Advised Fund that the distributee charity treats as fulfilling a pledge made by a donor, a donor advisor, or related person do not result in more than an incidental benefit if certain requirements are met. The Treasury Department and the IRS are also considering developing proposed regulations that would change the public support computation for organizations to prevent the use of Donor Advised Funds to circumvent the excise taxes applicable to private foundations. The notice requests comments regarding the issues addressed.

If regulations are issued as described in this notice, a beneficial development is that a Donor Advised Fund will be able to pay pledges, whether legally binding or not, made by the Donor of the Donor Advised Fund. Previously, the implications of satisfying a pledge with a grant from a Donor Advised Fund were unknown. One commentator has described the proposed IRS policy as "don't ask, don't tell."

GENERATION-SKIPPING TRANSFER TAX

30. Letter Rulings 201820007 and 201820008 (Issued February 5, 2018; Released May 18, 2018)

Proposed distribution from one generation-skipping tax exempt trust to another exempt trust will not cause either trust to lose their exempt status

These letter rulings concern irrevocable GST exempt trusts created after September 25, 1985. Separate trusts were established with identical terms for the benefit of the Settlor's two sons. Trust A was an irrevocable trust for the benefit of one son and Trust B was an irrevocable trust for the benefit of a second son.

The trustee could currently distribute income and principal to each son for the son's support, maintenance, education, and health. Upon the death of the son, the son had a limited

testamentary power of appointment to the issue of the Settlor. Otherwise the property passed per stirpes to the son's then living issue.

Trustee subsequently appointed all the principal and accumulated income of one of the trusts to a new trust, known as Trust C. During the son's lifetime, the distribution standard and trustee were the same as the distribution standard and trustee in Trust A. The son continued to have a testamentary limited power of appointment to the settlor's issue. However, Trust C expressly provided that the son could create a new trust for the benefit of permissible appointees. The beneficiary of each new trust was given a testamentary general power of appointment which would cause the assets of the trust to be included in the estate of the beneficiary at his or her death. Consequently, the distribution of property from Trust A to Trust C would not cause a shift to beneficial interest to lower generation or extend the time for vesting of any beneficial interest.

As a result, the proposed appointment from Trust A to Trust C would not cause the trust to lose its exempt status for GST purposes because the new trust satisfied the requirements of Treas. Reg. § 26.2601-1(b)(4)(i)(D) since the change would not shift any beneficial interest to a lower generation and would not extend the term of the trust beyond the period permitted in the original trust.

31. **Letter Ruling 201815012 (Issued November 14, 2017; Released April 13, 2018)**

Extension of time granted to allocate spouse's available GST exemption

Decedent while alive established an irrevocable trust for the benefit of decedent's children and their descendants. Decedent died survived by spouse and children. An accountant prepared the gift tax returns for the transfer to the trust and decedent's spouse elected to split gifts on the gift tax return. However, the CPA failed to allocate any GST exemption to the initial transfer to the trust. The error was discovered later when an attorney discovered that no GST exemption had been allocated to the transfer of the trust on the gift tax return. The spouse had sufficient GST exemption that year to completely exempt the trust from GST Tax and requested an extension of time to do so.

The Service ruled that under Section 2642(g)(1)(A) and Treas. Regs. §§ 301.9100-1 and 301.9100-3, an extension of time should be granted. The two regulations provide that an extension of time will be granted when the taxpayer shows that the taxpayer acted reasonably and in good faith and that granting relief will not prejudice the interests of the government. A taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional to make the election.

32. **Letter Ruling 201801001 (Issued September 20, 2017; Released January 5, 2018)**

Estate granted an extension of time to allocate GST exemption

When Decedent died, the residue of his estate passed to Trust 1. Trust 1, in turn, created an irrevocable sub-trust, Trust 2, for the benefit of Decedent's spouse and issue. An attorney prepared the Form 706; however, the attorney failed to allocate GST exemption to Trust 2.

The error was discovered subsequently when the surviving spouse and a son consulted a second attorney regarding the family estate planning and discovered that the GST exemption had not been allocated to Trust 2 on the Form 706. They then requested an extension of time to allocate GST exemption to Trust 2. Under Treas. Reg. § 301.9100-3, an extension of time will be granted when the taxpayer shows that the taxpayer acted reasonably and in good faith and that granting relief will not prejudice the interests of the government. The regulation provides that a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional and the tax professional failed to make or advise the taxpayer to make the election. The Service found that the requirements of Treas. Reg. § 9100-3 had been met and the request for an extension of time to allocate GST exemption was granted.

33. **Letter Rulings 201803001 and 201803002 (Issued September 18, 2017; Released January 19, 2018)**

Extension of time to allocate GST exemption granted

In these companion letter rulings, Donor established an irrevocable trust for the benefit of his child. Although the trust had GST potential, a portion of the trust had the potential to be included in the gross estate of a non-skip person other than the transferor if such person died immediately after the transfer. Donor retained an accountant and an attorney for advice on reporting the transfers and preparing the necessary Form 709. At all times, Donor indicated his intention that the trust be exempt from GST tax.

Accountant prepared a Form 709, on which Donor reported his transfers to the trust. However, in preparing the Form 709, his accountant failed to allocate GST exemption to the transfer to the trust. No Forms 709 were prepared for the thirteen subsequent years in which Donor made transfers to the trust based on the accountant's and attorney's advice that filing Forms 709 was unnecessary. At the time the error was discovered, Donor had sufficient GST exemption to allocate to the transfers. Donor requested an extension of time to allocate GST exemption to the transfers to the trust in years 1 through 3 and to treat the trust as a GST trust with respect to all transfers made by Donor to the trust.

Treas. Reg. § 301.9100-3 provides that an extension of time to make an election may be granted when the taxpayer shows that the taxpayer acted reasonably and in good faith and that granting relief will not prejudice the interests of the government. A taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional and the tax professional failed to make or advise the taxpayer to make the election. The IRS found

that the requirements of the regulation had been satisfied and granted an extension of time to allocate GST exemption to the gifts made in the first three years. In addition, Donor was granted an extension of time to treat the trust as a GST trust with respect to the transfers to the trusts in the fourth year and all subsequent transfers. That would cause the automatic allocation of Donor's unused GST exemption to the trust in those years.

34. Letter Ruling 201840002 (Issued July 2, 2018; Released October 5, 2018)

Grantor granted extension of time to allocate GST exemption to trust

Grantor created two irrevocable trusts for the benefit of grantor's descendants. An accounting firm prepared the gift tax returns. However, the grantor failed to allocate any of grantor's GST exemption to the transfers to the two trusts. The error was discovered in year two when a newly hired attorney was added to the grantor's advisory team at the law firm and the attorney discovered that no GST exemption had been allocated to the transfers to the two trusts on the gift tax return. The grantor requested an extension of time to allocate GST exemption.

The Service granted the request for an extension of time to allocate GST exemption. Treas. Reg. § 301.9100-3 provides that requests for an extension of time will be granted when the taxpayer provides evidence that the taxpayer acted reasonably and in good faith and that granting relief will not prejudice the interests of the government. A taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional and the tax professional failed to make or advise the taxpayer to make the election.

35. Letter Ruling 201839001 (Issued June 18, 2018; Released September 28, 2018)

Extension of time to allocate GST exemption granted

Settlor created an irrevocable charitable lead unitrust for the benefit of a foundation and the settlor's grandchildren. The settlor and his spouse agreed to split the gifts. The settlor engaged an accounting firm to prepare the gift tax returns for the settlor and the spouse. The gift tax returns did not allocate any of the settlor's or spouse's GST exemption to the trust. The error was discovered when the settlor's current tax advisor reviewed the trust agreement and the gift tax returns. Each of the settlor, the spouse, and the accounting firm signed affidavits stating that the settlor and spouse intended to allocate their available GST exemption to the trust.

The settlor and the spouse requested an extension of time to allocate their respective GST exemptions to the charitable lead unitrust. The Service granted the request for an extension of time to allocate GST exemption. Treas. Reg. § 301.9100-3 permits the granting of requests for relief when the taxpayer provides evidence that the taxpayer acted reasonably and in good faith and that granting relief will not prejudice the interests of the government. A taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied upon a qualified tax professional and the tax professional failed to make or advise the taxpayer to make an election.

36. Letter Rulings 201849007 and 201849008 (Issued July 31, 2018; Released December 7, 2018)

IRS grants an extension of time for grantors to allocate GST exemption to trust

Grantors created a trust for the benefit of their issue. An accountant prepared and filed the gift tax returns for Grantor 2's gifts to Trust 1 and Trust 2 in which Grantor 2 and spouse elected to split the gift under Section 2513. Accountant failed to allocate Grantor 2 and spouse's respective GST exemptions to the transfers to the trusts on two dates. Grantor 2 and spouse requested an extension of time pursuant to Treas. Reg. §§ 301.9100-1 and 301.9100-3 to allocate their GST exemptions to the transfers to the trusts on the two dates.

The Service granted the request for an extension of time because the requirements of Treas. Reg. § 301.9100-3 had been satisfied. Requests for relief will be granted when the taxpayer shows that the taxpayer acted reasonably and in good faith and that granting the relief will not prejudice the interests of the government. A taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional to make the election.

37. Letter Ruling 201850010 (Issued September 17, 2018; Released December 14, 2018)

IRS grants extension of time to sever QTIP trust into exempt and non-exempt QTIP trusts and to make a "reverse" QTIP election for the exempt QTIP trust and to apply the GST automatic allocation rules to allocate GST exemption to the exempt QTIP trust

Decedent died survived by spouse. Decedent's revocable trust, which contained the provisions for the disposition of decedent's assets after his death, provided that if spouse survived decedent, the trustee was to divide the trust into a QTIP marital trust and a bypass trust. Moreover, if the property allocated to the QTIP martial trust exceeded decedent's available GST tax exemption allocated to that trust, the trustee was to establish exempt and non-exempt QTIP trusts.

Upon decedent's death, decedent's estate retained a law firm to prepare the estate tax return. The estate made the QTIP election for the QTIP trust to qualify it for the estate tax marital deduction. However, the Form 706 prepared by the law firm failed to indicate that the QTIP trust was to be severed into exempt and non-exempt QTIP trusts and did not make a reverse QTIP election with respect to the exempt QTIP trust. As a result, none of decedent's GST exemption was allocated to the QTIP trust.

The law firm did not advise the estate of the need to sever the QTIP trust, make a reverse QTIP election, or apply GST exemption to the exempt QTIP trust. These errors were only discovered after the spouse's death.

The Service granted an extension of time to sever the QTIP trust into exempt and non-exempt QTIP trusts and to make a reverse QTIP election with respect to the exempt trust. It also ruled that the automatic allocation rules would automatically allocate decedent's unused GST exemption to the exempt QTIP trust as of the date of decedent's death.

These rulings were issued pursuant to Treas. Reg. §§ 301.9100-1 and 301.9100-3 which provide that an extension of time will be granted when the taxpayer establishes that the taxpayers acted reasonably and in good faith and the grant of relief will not prejudice the interests of the government. A taxpayer is deemed to have acted reasonably and in good faith if the taxpayer relied on a qualified tax professional and the tax professional failed to make or advise the taxpayer to make the election.

38. **Letter Rulings 201839003 (Issued June 18, 2018; Released September 28, 2018), and 201839012, and 201839014 (Issued June 21, 2018; Released September 28, 2018)**

Extension of time granted to opt out of automatic allocation rules

Taxpayer established an irrevocable grantor retained annuity trust. Taxpayer and spouse each filed a gift tax return and consented to have the transfers to the grantor retained annuity trust as having been made one-half by each spouse. Each trust had GST potential.

An accountant was responsible for preparing the gift tax returns for the taxpayer and spouse. The accountant failed to advise the taxpayer and spouse that it was necessary to file a gift tax return for the second year to opt out of an automatic allocation of GST exemption when the estate tax inclusion period (ETIP) ended. The spouse or the taxpayer in these rulings requested an extension of time to opt out of the automatic allocation rules.

The IRS granted the request of the taxpayer and the spouse. Treas. Reg. § 301.9100-3 provides that requests for relief will be granted when the taxpayer provides evidence to establish that the taxpayer acted reasonably and in good faith and that the grant of relief will not prejudice the interests of the government. The taxpayer is deemed to have acted reasonably and in good faith of the taxpayer reasonably relied on a qualified tax professional and the tax professional failed to make or advise the taxpayer to make the election.

39. **Letter Rulings 201836004 and 201836007 (Issued June 5, 2018; Released September 7, 2018)**

Spouse's allocation of GST exemption to three trusts was void under Treas. Reg. § 26.2632-1(b)(4)(i) because trusts had no GST potential with respect to spouse

Taxpayer established three irrevocable trusts for the primary benefit of his three children respectively. The terms of each trust provided for discretionary distributions of income for the health, education, and support of each child. Upon the death of the second to die of taxpayer and spouse, the trustee could make discretionary distributions of principal for the health, education, and support of the child. The child had the right to withdraw the principal of the trust at four different ages. Each trust granted the child a testamentary general power of appointment to the child's estate, the creditors of the child's estate, or to any person or corporation.

The taxpayer made gifts to the trust in year 1 and year 2. The taxpayer and spouse each filed a gift tax return. On each form, the taxpayer and spouse signified their consent to treat each transfer as having been made one-half by each spouse under section 2513. On each gift tax

return, taxpayer and spouse erroneously allocated GST exemption to the transfers to the three trusts.

The taxpayer and the spouse requested rulings that the allocations of GST exemption made to the three trusts were void because there was no GST potential with respect to those transfers.

The Service found that the trust had no GST potential with respect to the taxpayer or the spouse. The child was the primary beneficiary of each trust. The trustee was only authorized to make distributions of income and principal to the child. The child could withdraw amounts of principal from the trust upon reaching different ages. None of the payments were payments to skip persons and therefore, none were generation-skipping transfers with respect to the taxpayer or the spouse. Upon the child's death, the child had a testamentary general power of appointment, which would cause the property in the trust to be included in the child's estate. As a consequence, the child would be the transferor of any payments made from the trust after the death of the child. Consequently, because there was no GST potential, the taxpayer and the spouse's allocation of GST exemption to the trust was void under Treas. Reg. § 26.2632-1(b)(4)(i). This regulation provides that an allocation of GST exemption to a trust is void to the extent that the amount allocated exceeds the amount necessary to obtain an inclusion ratio of zero with respect to the trust. An allocation is also void if the allocation is made with respect to a trust that has no GST potential with respect to the transferor making the allocation at the time of the allocation.

40. **Letter Rulings 201811002 and 201811003 (Issued November 27, 2017; Released March 16, 2018)**

Service rules on application of split-gift rules to the allocation of GST exemption

These two rulings dealt with the same transaction. Husband created four irrevocable trusts, one for each of his four children of which each child was the primary beneficiary. Upon each child's death, the principal was to be held in further trust and distributed outright to the child's children upon those children obtaining age 35. An accounting firm prepared the gift tax returns for husband and wife. Husband and wife consented to treat the gifts as being split between them. However, husband's gift tax return reported his portion of the total transfer to the trust to be 3/4 (rather than 1/2) of the amount actually transferred to the trust. Wife's gift tax return reported her portion of the total transfer to the trust to be 1/4 (rather than 1/2) of the amount transferred to the trust. No amount of either husband's or wife's available GST exemption was allocated to the transfers on the gift tax returns.

Several years later, after discovering the error, the accounting firm advised husband of the ability to make a late allocation of GST exemption to the trust. The accounting firm prepared husband's new gift tax return to include the late allocation of GST exemption to the original transfers to the trust. The late allocation of husband's GST exemption erroneously allocated an amount equal to 100% of the value of the initial transfers to the trust with such value determined as of the effective date of the allocation. The notice of allocation attached to the new gift tax return stated that, as a result of the late allocation, the inclusion ratio of the trust was zero. Wife was not

advised to make a late allocation of GST exemption to wife's portion of the initial transfers to the trust.

A ruling was requested that because the period for the assessment of gift tax had expired, the husband was to be treated as the transferor of the amount reported for husband's portion of the initial transfers on the initial gift tax return. In addition, rulings were also requested that the wife was to be treated as the transferor of the amount reported for wife's portion of the initial transfers to the trust on wife's initial gift tax return and that an extension of time would be granted to wife's estate to make a timely allocation of GST exemption to wife's portion of the initial transfers to the trust.

The Service ruled that because the time had expired under Section 6501 as to when a gift tax may be assessed, the husband was treated as having transferred 3/4 of the total amount to the trust and wife was treated as having transferred 1/4 for gift tax purposes.

However, under Treas. Reg. § 26.2652-1(a)(4), husband is regarded for generation-skipping tax purposes as the transferor of 1/2 of the total value of the property transferred to the trust regardless of the interest that husband was treated as having transferred for gift tax purposes. As a result, husband's late allocation of the GST exemption to the trust on the Form 709 was effective only to 1/2 of the property transferred to the trust. The Service granted the request of wife's estate for an extension of time to allocate GST exemption to the trust for her portion. It found that the requirements of Treas. Reg. § 9100-3 had been met. Under this regulation, requests for relief will be granted when the taxpayer shows that the taxpayer acted reasonably and in good faith and that granting relief will not prejudice the interests of the government. A taxpayer is deemed to have acted reasonably and in good faith when the taxpayer reasonably relied on a qualified tax professional. Wife's GST exemption would be allocated to 1/2 of the transferred property and the allocation would effective as to the date of the transfer to the trust.

41. Letter Rulings 201814001 and 201814002 (Issued December 11, 2017; Released April 6, 2018)

Construction of ambiguous terms of grandfathered GST trust will have no adverse generation-skipping tax, gift tax, or income tax consequences

Settlor established an irrevocable trust for the benefit of his lineal descendants prior to September 25, 1985. Consequently, the trust was grandfathered from the GST tax. The current trustees of the trust were child, individual, and a bank. The terms of the trust were ambiguous. However, Settlor was currently living at the time of the ruling request and attested that at the time the trust was created and all times thereafter, Settlor intended for the trust only to benefit blood descendants. The trustees petitioned the State Court for declaratory judgments construing the ambiguous terms of the trust consistent with Settlor's intent to benefit only blood descendants and the State Court entered that order conditioned upon the trustees obtaining a favorable ruling by the Internal Revenue Service that the order would have no adverse generation-skipping tax, gift tax or income tax consequences.

The Service first ruled that the terms of the trust presented a bona fide issue regarding whether an adopted grandchild of the Settlor was considered a member of the class of issue, descendants, or children. It also ruled that the State Court's order construing the ambiguous terms was consistent with the applicable state law that would be applied by the highest court of the state. The Service here followed Treas. Reg. § 26.2601-1(b)(4)(i)(C) which provides that a judicial construction of a governing instrument to resolve an ambiguity in the terms of the instrument to correct a scrivener's error will not cause an exempt trust to be subject to the generation skipping tax if the judicial action involves a bona fide issue and the construction is consistent with the applicable state law that would be applied by the highest court of the state, pursuant to Commissioner v. Estate of Bosch, 387 U.S. 456 (1967). Here the declaratory judgment met the requirements of the Treasury regulations and the construction of the trusts would not affect its exempt status.

Next, the Service ruled that because the State Court's order clarified the ambiguous terms at issue, the order construing the ambiguous terms was not a transfer for gift tax purposes and was not a taxable gift pursuant to Section 2501. Finally, the Service ruled that because the State Court's order resolved an ambiguity as to the construction of the trust and carried out the intent of the Settlor rather than resulting in a disposition of the interest of the trust, there would be no realization of gain or loss to the trust for income tax purposes.

42. Letter Ruling 201818005 (Issued January 16, 2018; Released May 4, 2018)

Partition of trust in accordance with terms of partition order will have no adverse income, gift, or generation-skipping tax consequences

Grantor created a trust prior to September 25, 1985. Consequently, the trust was grandfathered from GST tax. The trust was created for the primary benefit of daughter, four grandchildren, and four great grandchildren. In a previous partition proceeding, the trust was divided along the family line into five separate trusts. In the ruling addressing that partition, the Service ruled that the first partition order would not cause the trust to realize gain or loss from any sale or disposition; would not result in a transfer by any beneficiary of the trust subject to the gift tax; and would not cause distributions from the trust to be subject to GST tax.

This later ruling request applied only to one of the five trusts. This trust was for the benefit of one granddaughter who had five living children. In the second partition order, the court modified the granddaughter's trust to provide that upon the death of the granddaughter, her trust would be equally divided or partitioned into separate trusts for the benefit of each living child of that granddaughter and for the benefit of each group comprised of the living descendants of a deceased child of the granddaughter per stirpes. The Service ruled that the modification of the granddaughter's trust would not be considered an exchange of property resulting in the realization of gain or loss. This was because there would be no material difference in the positions of the beneficiaries of the trust before and after the partition. In addition, there would be no adverse gift tax consequences.

With respect to the GST tax, the Service ruled that the fact pattern in this letter ruling was similar to Treas. Reg. § 26.2601-1(b)(4)(i)(E), Example 5. In that example, the Service stated that the division of a grandfathered irrevocable trust for the benefit of two children and their issue would not have adverse GST tax consequences upon a court-approved division of the trust into two equal trusts, one for the benefit of each child and his or her issue. This is because the division of the trust did not shift any beneficial interest in the trust to a beneficiary in a lower generation. In addition, the division would not extend the time for vesting of any beneficial interest in the trust beyond a period provided for in the original trust. Essentially the same fact pattern as in Example 5 applied here and the Service ruled that there were no adverse generation-skipping tax consequences.

43. **Letter Ruling 201825007 (Issued March 15, 2018; Released June 22, 2018)**

Modification of GST grandfathered trust will not affect exempt status

Decedent created a trust for the benefit of his daughter and her descendants through his will. Decedent died prior to December 26, 1985 and the trust was grandfathered from GST tax. The trust was initially administered in State A. The court in State A issued a final order modifying the method of determining the income of the trust. Under the modification, the trustees were to distribute an amount equal to the greater of the trust's annual net income or X percent of the total value of the trust determined on the first date of each year. This was done pursuant to a statute in State A. This order was contingent on the receipt of a favorable ruling from the IRS.

Subsequently, the situs of the trust was moved to State B. The corporate trustee now sought to modify the method for determining the trust income. Under the proposal, the annual distribution amount to be paid by the trustees would be a unitrust amount. The trustee also sought an ordering rule for determining the character of the annual trust distributions for income tax purposes in accordance with the State B's statute. In all other respects, the terms of the trust would be identical to the original trust.

In general, a modification of the governing instrument of an exempt trust will not cause an exempt trust to be subject to the GST tax if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation than the person or persons who currently are the beneficiaries and the modification does not extend the time for vesting any beneficial interest in the trust beyond the period provided for in the original trust. See Treas. Reg. § 26.2601-1(b)(4)(i)(D)(1). Based on examples in the treasury regulations, the IRS ruled that the proposed changes would not shift a beneficial interest to a beneficiary in a lower generation and would not extend the time for the vesting of any beneficial interest beyond the period provided for in the original trust. As a result, the modification of the method of determining trust income and the adoption of the ordering rule would not cause the trust to lose its GST exempt status.

44. Letter Ruling 201825023 (Issued March 9, 2018; Released June 22, 2018)

IRS grants decedent's estate an extension of time to sever a residuary trust into an exempt and non-exempt residuary trust

Upon decedent's death, the residue of decedent's revocable trust was to be held in a residuary trust that had GST tax potential. In addition, one paragraph of the trust directed the trustee to divide any trust into two separate sub trusts of equal or unequal value whenever the division was necessary or desirable to minimize transfer or other taxes. Finally, the trust provided that the trust should be construed in a matter consistent with decedent's objective of using all available GST tax exemptions and to have trusts that were either entirely exempt or entirely non-exempt.

The executors engaged a law firm to prepare a Form 706. An accounting firm was retained to advise the estate on income tax issues arising as a result of decedent's death. Neither the law firm nor the accounting firm advised decedent's estate of any gifts or distributions to grandchildren that would have a GST impact. Moreover decedent's estate was not advised to divide the residuary trust into separate exempt and non-exempt trusts to effect decedent's GST planning. The estate tax return was timely filed but did not evidence any attempt to divide the residuary trusts into exempt or non-exempt trusts. The executors requested an extension of time to sever the residuary trust into exempt and non-exempt trusts and a ruling that the automatic allocation rules would cause any unused portion of decedent's GST exemption to be allocated to the exempt residuary trust.

Treas. Reg. § 26.2654-1(b)(1)(ii) provides that the severance of a trust that is included in the transferor's gross estate into two or more trusts will be recognized for generation-skipping tax purposes if the trust is severed pursuant to discretionary authority granted either under the governing instrument or under local law. The terms of the new trust must provide for the same succession of interests and beneficiaries as provided in the original trust. The severance needs to occur prior to the date prescribed for filing the federal estate tax return for the estate of the transferor. The severance must occur on either a fractional basis or if a pecuniary basis severance is required, it meets the requirements for payments to individuals.

Based upon the facts submitted, the IRS concluded that the requirements of Treas. Reg. § 301.9100-3 were satisfied. This regulation provides that requests for relief will be granted when the taxpayer provides evidence to show that the taxpayer acted reasonably and in good faith and that granting the relief will not prejudice the interests of government. A taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional, including a tax professional employed by the taxpayer.

FIDUCIARY INCOME TAX

45. Letter Ruling 201807001 (Issued November 13, 2017; Released February 16, 2018)

IRS recognizes reformation of trust to qualify as a grantor trust for income tax purposes

Donor created a trust which he intended to be a grantor trust prior to August 20, 1996. The Donor was not a citizen of the United States. At the time Donor executed the trust, he was not married and had no issue. Subsequently, Donor married and had issue. None of Donor, Donor's spouse, and Donor's issue were ever United States citizens.

The trust, as originally drafted, provided that the independent trustee during the lifetime of Donor, could distribute the income and principal of the trust to or for the benefit of Donor and Donor's issue.

Prior to August 20, 1996, the trust was treated as a grantor trust for income tax purposes; however, as a result of the Small Business Job Protection Act in 1996, which became effective on August 20, 1996, the grantor trust rules only apply in computing the income of a citizen or resident of the United States. There was an exception that provides that a trust would be treated as a grantor trust if during the lifetime of the grantor distributions could only be made to a non-citizen grantor or the non-citizen spouse. As a result of the Small Business Job Protection Act, after August 20, 1996, the trust was no longer a grantor trust.

The grantor filed a reformation suit to eliminate the issue as beneficiaries of the trust so that the trust could be treated as a grantor trust for income tax purposes. The grantor and the attorney who drafted the trust testified that Donor always intended the trust to be a grantor trust from its inception and the court granted the request for reformation and the issue were eliminated as beneficiaries.

The IRS held that the transcripts and representations of the party showed that Donor intended that the trust be a grantor trust with respect to Donor and that this intent was not carried out in the trust agreement as a result of a mistake of fact or law. As a result, the trust reformation was to be taken into account as of the initial date of the trust, so that the exception would permit the trust to be a grantor trust for income tax purposes from inception.

46. Letter Ruling 201803004 (Issued September 28, 2017; Released January 19, 2018)

IRS grants extension to trust for charitable contribution election

The trustees of a trust made charitable contributions during Year 2. The trust filed a return for Year 1 treating the charitable contributions made in Year 2 as paid in Year 1. An exception in Section 642(c) permits a charitable contribution paid after the close of the taxable year and on or before the last day of the year following the close of that taxable year to be treated as paid during such taxable year if an election is made. This is permitted if an election is filed under Section

642(c). However, due to inadvertence, the Section 642(c) election was not included with the Year 1 Form 1041 return for the trust. The income tax return filed for Year 2 did not take a deduction for the charitable contributions made in Year 2.

In this letter ruling, the Service applied the provisions of Treas. Reg. § 301.9100-3, which states that a request for relief will be granted when a taxpayer shows that the taxpayer acted reasonably and in good faith and that grant of relief will not prejudice the interests of the government. The IRS found that these requirements were met without much discussion, and the trust could take the Section 642(c) deduction in Year 1.

47. <u>Green v. United States</u>, 880 F.3d 519 (10th Cir. 2018)

Income tax charitable deduction for non-grantor trust limited to trust's adjusted basis in properties donated to charity

David M. Green and Barbara A. Green created an irrevocable dynasty trust in 1993. The beneficiaries of the dynasty trust were the children and descendants and charity. The trust stated that a distribution could be made from the trust to charity, but only to the extent that the deduction would not prevent the trust from qualifying as an electing small business trust or an S corporation. The trust owned a single member limited liability company called GDT which was disregarded for income tax purposes.

Hob-Lob Limited Partnership ("Hob-Lob") owns and operates most of the Hobby Lobby retail stores located nationwide. The trust was a 99% limited partner in Hob-Lob. In 2003, GDT purchased 109 acres of land in two industrial buildings in Lynchburg, Virginia for $10.3 million. GDT obtained the money to purchase the property through a distribution from Hob-Lob to the trust in 2003.

On March 19, 2004, GDT donated 73 of the 109 acres of land and the two industrial buildings to the National Christian Foundation Real Property, Inc. The National Christian Foundation is a recognized charity. The trust reported that its adjusted basis in Virginia property was $10,368,113 on the date of the donation.

In 2002, GDT purchased a church building and several out buildings in Ardmore, Oklahoma for $150,000. Subsequently in 2004, GDT donated the Ardmore property to the Church of the Nazarene. Its adjusted basis in the property is $160,477 and the property had a fair market value of $355,000.

In June 2003, GDT purchased 3.8 acres of land in Texas for $145,000. On October 5, 2004, GDT donated the Texas property to Lighthouse Baptist Church. The trust reported that its adjusted basis in the Texas property was $145,180 and the fair market value of the property was $150,000 on the date of the donation.

In October 2005, the trust filed its income tax return for 2004. The return claimed a charitable deduction totaling $20,526,383. This included the donations of real property as well as a $1,851,502.42 donation to Reach the Children Foundation, Inc. The return reported the trust's total adjusted basis in the three donated real properties as approximately $10.7 million, and that

the properties' fair market value at the time of the donation was approximately $30.3 million. At no point in 2004 or any other tax year did the trust report as its income the properties' unrealized appreciation of approximately $19.6 million. On October 15, 2008, the trust filed an amended Form 1041 claiming a refund from the Internal Revenue Service for $3,194,748 in income tax and increasing the trust's reportable charitable deduction from $20,526,383 to $29,654,233.

The IRS denied the refund claim by the trust. It stated that the charitable deduction for the real property donated in 2004 was limited to the basis of the property contributed. The Western District of Oklahoma granted partial summary judgment in favor of the trust, concluding the trust was statutorily authorized to take a deduction equivalent to the fair market value of the properties as of the time of the donation.

On appeal, the Circuit Court first looked at the language of Section 642(c)(1). It stated that the Section applies only to estates and trusts. The deduction is limited to any amount of gross income which pursuant to the terms of the governing instrument paid for a charitable purpose. The Circuit Court then said that the central issue in this appeal is the amount of the deduction is under Section 642(c)(1).

The Circuit Court stated that there were four possible interpretations of the statutory language. One possible interpretation of the statutory phrase is that a charitable contribution must be made out of the gross income earned by the trust during the year in question.

A second possible interpretation is that a charitable contribution must be made exclusively out of gross income earned by the trust at some point in time, so long as that gross income is kept separate from the trust principal from the time it is earned until it is donated.

The third possible interpretation, and the one that both parties in the case appeared to urge, is that a charitable contribution need not be made directly from, but must instead simply be traceable to, current or accumulated gross income. If applied to contributions of real property, that would mean that the real property must have been purchased with, i.e. sourced from, the trust's current or accumulated gross income.

The fourth and final possible interpretation is that the amount of the charitable deduction is capped or limited by the amount of gross income earned by the taxpayer in the tax year in question.

Consequently, the statutory phrase "any amount of the gross income" was viewed by the Circuit Court as ambiguous.

The Circuit Court disagreed with the District Court's finding that the deduction should extend to the full amount of the fair market value of the donated property. Instead, it agreed with the IRS that the amount of the deduction should be limited to the adjusted basis in the property. The Circuit Court noted that because the trust never sold or exchanged the properties at issue and never realized the gains associated with their increases in market value, the trust was never subject to being taxed from those gains. Consequently, construing the Section 642(c)(1)

charitable deduction to extend to unrealized gains would be inconsistent with the Internal Revenue Code's general treatment of gross income.

The Circuit Court found that until Congress acted to make clear that it intended for the Section 642(c)(1) deduction to extend to unrealized gains associated with real property originally purchased with gross income, that it cannot construe the deduction in that manner. It also noted that its interpretation found support in Mertens Law of Federal Income Taxation, which states that where appreciated property purchased from accumulated gross income is donated, the amount of the deduction is limited to the adjusted basis of the property rather than based on the fair market value of the donated property as well as, in part, in a decision dealing with the predecessor statute to Section 642(c)(1), W. K. Frank Trust of 1931 v. the Commissioner, 145 F.2d 411 (3d Cir. 1944). The Circuit Court also stated that if Congress had intended for the concept of "gross income" to extend to unrealized gains on property purchased with gross income, it would have said so.

The court finally rejected the argument of the trust that Section 512(b)(11) provided an alternative path for a deduction for charitable contributions by trusts that are sourced from unrelated business income. The trust argued that through the operation of Section 512(b)(11), its contribution of donated properties was deductible under Section 170. The Circuit Court rejected this theory, because the trust's claim for a refund made no mention of its Section 512(b)(11) legal theory, and this theory was never clearly raised and/or resolved by the District Court. The case was remanded to the District Court with directions to enter summary judgment in favor of the government.

48. **Kimberly Rice Kaestner 1992 Family Trust v. North Carolina Department of Revenue, 371 N.C. 133 (2018); Petition for Writ of Certiorari granted on January 11, 2019 by U.S. Supreme Court**

N.C. Supreme Court holds that income taxation of out-of-state trust is unconstitutional

On June 8, the North Carolina Supreme Court affirmed the Court of Appeals' 2016 decision in Kimberly Rice Kaestner 1992 Family Trust v. North Carolina Department of Revenue, _____ N.C. _____ (2018), upholding the Court of Appeals' (and Business Court's) finding that North Carolina General Statute Section 105-160.2 is unconstitutional as applied to the Kimberly Rice Kaestner 1992 Family Trust. The trust challenged the state of North Carolina's imposition of income tax on the basis that the trust's sole tie to the state is the residency of the trust's beneficiary, which connection is insufficient to allow taxation under the due process and commerce clauses of the U.S. Constitution.

The trust sought a refund of over $1.3 million in income taxes paid to the state of North Carolina for tax years 2005 – 2008. Upon denial of the claim, the trust brought suit challenging the constitutionality of the statute, both on its face and as applied to the taxpayer (the trust). Each of the Business Court, Court of Appeals, and North Carolina Supreme Court focused on the unique facts of the case in finding that the statute is unconstitutional as applied to the trust.

The trustee, during the period taxes were assessed, was a resident of Connecticut, the trust was governed by New York law, and North Carolina's only connection to the trust was the residence of the beneficiary. Further, all custodians of the trust's assets were located in Massachusetts, while all documents related to the trust, such as ownership documents and financial and legal records, were kept in New York. Finally, distributions from the trust were in the discretion of the trustee, and no distributions were made to the beneficiary in North Carolina during the relevant period.

The North Carolina Supreme Court emphasized that its opinion is limited to an "as applied" standard, meaning the court considered only whether the statute is constitutional as applied to the trust. In responding to the trust's continued challenge to the constitutionality of the statute, on its face, the North Carolina Supreme Court noted the presumption that "any act passed by the legislature is constitutional" and "any individual challenging the facial constitutionality of a legislative act must establish that ***no*** set of circumstances exists under which the [a]ct would be valid" (emphasis added). Because the trust presented only facts and evidence relevant to it, the North Carolina Supreme Court did not (and could not) consider whether the statute is unconstitutional on its face.

It has long been settled that a trust has a separate existence from its beneficiary, and therefore income to the trust is separately attributed. In determining whether the statute is constitutional, as applied to the trust, the North Carolina Supreme Court evaluated the requirements of the due process clause, specifically that the entity being taxed must "purposefully direct its activities" at the state, and the activities must be sufficiently abundant that the entity invokes the benefits and protections of that state's laws. Therefore, in order to withstand this challenge, the presence of the trust beneficiary in the state must satisfy the "purposeful" requirement to allow taxation of the trust. The North Carolina Supreme Court concluded that the unilateral activity of the beneficiary did not satisfy this requirement.

Interestingly, Justice Sam Ervin, in dissent, noted the advancements of modern technology related to online and telephone communications, rather than in person. He opined a traditional analysis of physical presence in a state may need to be amended to reflect those changes in determining whether a taxpayer purposefully directs its activities to a state.

With the North Carolina Supreme Court's limited scope decision, as applied solely to the trust, taxpayers and advisers should carefully evaluate whether tax is due by a trust in North Carolina. For taxes already paid, and to the extent that a trust's *sole* connection with North Carolina is the residence of a trust beneficiary, the trustee should consider filing a claim for refund.

The United States Supreme Court granted the North Carolina Department of Revenue's petition for a writ of certiorari on January 11, 2019. It has been set for argument on Tuesday, April 15.

49. **<u>Fielding v. Commissioner</u>, 916 N.W.2d 323 (Minn. 2018)**

Attempt of Minnesota to tax irrevocable non-grantor trusts as resident trusts for state income tax purposes is unconstitutional under the due process clauses of United States and Minnesota Constitutions

Reid MacDonald, who was then domiciled in Minnesota, created four GST trusts on June 25, 2009. Each trust was initially funded with shares of nonvoting common stock in Faribault Foods, Inc. a Minnesota S Corporation. The original trustee for all four trusts was Edmund MacDonald, a California domiciliary. Reid MacDonald retained the power to substitute assets in the trusts. Consequently for the first thirty months of their existence, the trusts were "grantor type trusts". On December 31, 2011, Reid MacDonald relinquished his power to substitute assets in the trusts and the trusts ceased to be "grantor type trusts" and became irrevocable on December 31, 2011 (according to the court). Reid MacDonald was a resident of Minnesota at the time the trusts became irrevocable. As a result, each trust was then classified as a "resident trust" under Minn. Stat. § 290.01, subd. 7b(a)(2). Katherine Boone, a Colorado domiciliary, became the sole trustee for each trust on January 1, 2012.

Subsequently, the trusts filed Minnesota income tax returns as resident trusts, without protest, in 2012 and 2013. On July 24, 2014, William Fielding, a Texas domiciliary, became trustee of the trusts. Shortly thereafter, all of the shareholders, including the trusts, sold their shares in Faribault Foods, Inc. Because the trusts were defined to be Minnesota residents as a result of Reid MacDonald's Minnesota domicile in 2011, the trusts were subject to tax on the full amount of the gain from the 2014 sale of the stock as well as the full amount of income from other investments. The trusts filed their 2014 Minnesota income tax returns under protest, asserting that the Minnesota statute classifying them as resident trusts was unconstitutional as applied to them. The trusts then filed amended tax returns claiming refunds for the difference between the tax owed as resident trusts and the tax owed as non-resident trusts – a tax savings of more than $250,000 for each trust.

The Minnesota Commissioner of Revenue denied the refund claims and the Commissioner's decision was appealed to the Minnesota Tax Court on the grounds that the Minnesota statute violated the due process and commerce clauses of the United States and Minnesota constitutions. The trusts and the Commissioner each moved for summary judgment. The Minnesota Tax Court ultimately concluded that defining the trust as a resident trust based upon Reid MacDonald's Minnesota residency at the time the trusts became irrevocable violated the due process provisions of the Minnesota and United States constitutions. The Minnesota Tax Court stated that the grantor's domicile at the time the trust becomes irrevocable was not "a connection of sufficient substance" to support taxing the trusts. Having decided the case on due process grounds, the Minnesota Tax Court did not reach the Commerce Clause.

The Minnesota Tax Court noted that a state's tax will satisfy the due process clause if there is some minimum connection between the state and the entity subject to the tax and a "rational relationship" between the income that the state seeks to tax and the protections and benefits conferred by the state citing <u>Luther v. Commissioner of Revenue</u>, 588 N.W. 2d 502 (Minn. 1999).

The Minnesota Supreme Court framed the issue as whether Minnesota may permissibly tax all sources of income to the irrevocable trusts simply because it had classified the trusts as residents based on events that predated the tax year at issue.

The Minnesota Tax Commissioner cited the following as factors requiring taxation:

1. Reid MacDonald was a Minnesota resident when the trusts were created;
2. Reid MacDonald was domiciled in Minnesota when the trusts became irrevocable and was still domiciled in Minnesota in 2014;
3. The trusts were created in Minnesota with the assistance of a Minnesota law firm which drafted the trust documents and until 2014 retained the trust documents;
4. The trusts held stock in a Minnesota S Corporation;
5. The trust documents provided that questions of law arising out of the trust documents were to be determined in accordance with Minnesota law; and
6. One beneficiary had been a Minnesota resident through the tax years in question.

The trusts, on the other hand, noted that:

1. No trustee had been a Minnesota resident;
2. The trusts had not been administered in Minnesota;
3. The records of the trust assets and income were maintained outside of Minnesota;
4. Some of the trusts' income was derived from investments with no direct connection to Minnesota; and
5. Three of the four beneficiaries of the trusts lived outside of Minnesota.

The Minnesota Supreme Court concluded that the contacts on which the Tax Commissioner relied were either irrelevant or too attenuated to establish that Minnesota's tax on the trusts income from all sources complied with due process requirements. It first noted the grantor's connections to Minnesota were irrelevant. The relevant connections were Minnesota's connection with the trustee and not the grantor who established the trusts years earlier.

It noted also that the stock was an intangible asset and cited cases holding that states cannot impose an income tax on trust property because possession or control of these assets was held by trusts that were not residents of or domiciled in a state. In addition, the Minnesota residency of one beneficiary did not establish the necessary minimum connection to justify taxing the trusts income. The grantor's decision to use a Minnesota law firm and the contacts with Minnesota predating 2014 were irrelevant.

As a result, the contacts between the trusts and Minnesota from 2014 on were tenuous. The trusts had no contact with Minnesota during the applicable tax year. All trust administration activities by the trustees occurred outside Minnesota.

The Court also noted that these trusts were inter vivos trusts that had not been probated in Minnesota courts and had no existing relationship to the Minnesota courts distinct from that of

the trusts and the trust assets unlike other cases which involved testamentary trusts such as District of Columbia v. Chase Manhattan Bank, 689 A. 2d. 539 (DC 1997).

Attributing all income, regardless of source, to Minnesota for tax purposes would not bear a rational relationship with the limited benefits received by the trusts from Minnesota during 2014.

50. **South Dakota v. Wayfair, Inc., ___ U.S. ___ (2018)**

Supreme Court overrules Quill Corp. v. North Dakota

South Dakota, as many states, taxes the retail sales of goods and services in the state. Sellers are required to collect and remit the tax to the state, but if they do not, then in-state consumers are responsible for paying a use tax at the same rate. Under National Bellas Hess, Inc. v. Department of Revenue of Ill. 386 U.S. 753 (1967) and Quill Corp, Inc. v. North Dakota, 504 U.S. 289 (1992), South Dakota could not require a business that has no physical presence in South Dakota to collect its sales tax. Consumer compliance rates are notoriously low, however, and it is estimated that Bellas Hess and Quill caused South Dakota to lose between $48 and $58 million in tax revenue, annually. Out of a concern about the erosion of its sales tax base and the corresponding loss of funding for state and local services, the South Dakota legislature enacted a law requiring out of state sellers to collect and remit sales tax "as if the seller had a physical presence in the state." The act covers only sellers that, on an annual basis, deliver more than $100,000 of goods or services into South Dakota or engage in 200 or more separate transactions for delivery of goods or services into South Dakota.

Respondents were top online retailers with no employees or real estate in South Dakota, each meeting the minimum sales or transactions requirement. They did not collect the sales tax imposed by South Dakota. South Dakota filed suit in state court seeking a declaration that the requirements of the act were valid and applicable to the respondents and an injunction requiring respondents to register for licenses to collect and remit the sales tax. Respondents sought summary judgment, arguing that the act is unconstitutional. The trial court granted their motion. The South Dakota Supreme Court affirmed on the ground that Quill is controlling precedent.

In a five to four opinion, the Supreme Court held that the physical presence rule of Quill is unsound and incorrect and overruled Quill and National Bellas Hess. The Court noted that the physical presence rule has long been criticized as giving out of state sellers an advantage. It also noted that each year, the physical presence rule becomes further removed from economic reality and results in significant revenue losses to the states. The Court felt that the physical presence rule is not a necessary requirement to satisfy due process concerns that there be some definite link or some minimum connection between a state and the person, property, or transaction it seeks to tax. In addition, Quill created resolved market distortions rather than resolving them. The Court observed that Quill was a judicially created tax shelter for businesses that limited their physical presence in a state, but sold their goods and services to consumers in a state, something that had become easier and more prevalent with the advancement of technology. Finally, Quill imposed the sort of arbitrary, formalistic distinction that the court's modern commerce clause precedents disavowed in favor of a case-by-case analysis of the purposes and effects.

51. Notice 2018-61, 2018-31 IRB (July 13, 2018)

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

The U.S. Treasury Department and the IRS announced on Friday, July 13, 2018, that they intend to issue regulations on the impact of new Section 67(g) of the Internal Revenue Code of 1986 on certain deductions for estates and nongrantor trusts. Section 67(g) was added to the Code by the 2017 Tax Act (P.L. 115-97) and suspends temporarily miscellaneous itemized deductions.

Tax practitioners expressed concern that Section 67(g) might inadvertently eliminate the deduction for costs of estate and trust administration. Practitioners have also requested guidance on whether the suspension of miscellaneous itemized deductions prohibits trust and estate beneficiaries from deducting on their individual returns the excess deductions of the trust or estate incurred during the trust's or estate's final taxable year.

Treasury and the IRS have stated that forthcoming regulations will clarify that the costs of trust or estate administration are not miscellaneous itemized deductions suspended by Section 67(g). Treasury and the IRS have also stated that new regulations will address the impact of Section 67(g) on the ability of beneficiaries to deduct an estate's or trusts excess deductions upon termination of the estate or trust.

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

New Section 67(g) of the Code suspends the deduction for miscellaneous itemized deductions for any taxable year beginning after December 31, 2017, and before January 1, 2026. Some practitioners expressed concern that Section 67(g) may inadvertently eliminate the ability of an estate or nongrantor trust to deduct the administration expenses described in Section 67(e)(1).

On the termination of a nongrantor trust or estate, Section 642(h) of the Code allows the beneficiaries succeeding to the property of the nongrantor trust or estate to deduct the trust's or estate's unused net operating loss carryovers under Section 172 of the Code and unused capital loss carryovers under Section 1212 of the Code. If an estate or nongrantor trust has deductions (other than deductions for personal exemptions or charitable contributions) in excess of gross income in its final taxable year, then Section 642(h) allows the beneficiaries succeeding to the property of the estate or trust to deduct such excess on their individual returns. Capital loss carryovers and net operating loss carryovers are taken into account in calculating adjusted gross

income and are not miscellaneous itemized deductions. Section 67(g) therefore does not affect the ability of a beneficiary to make use of a capital loss carryover or net operating loss carryover received from an estate or nongrantor trust.

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

Notice 2018-61 announces that Treasury and the IRS intend to issue regulations "clarifying that estates and nongrantor trusts may continue to deduct expenses described in Section 67(e)(1)" for taxable years during which Section 67(g) suspends miscellaneous itemized deductions. Estates and nongrantor trusts may rely on Notice 2018-61 in continuing to deduct expenses under Section 67(e)(1).

Notice 2018-61 includes a reminder that Section 67(g) does not affect the determination of administration costs defined in Section 67(e)(1) of the Code. Pre-existing law continues to apply to the identification of administration expenses under Section 67(e)(1), including the treatment of "bundled" trustee's fees.

Notice 2018-61 also notes that Treasury and the IRS are studying whether Section 67(e) deductions and other deductions that would not be considered miscellaneous itemized deductions to an estate or nongrantor trust should continue to be regarded as miscellaneous itemized deductions when included by a beneficiary as an excess deduction under Section 642(h)(2). Treasury and the IRS intend to issue regulations addressing whether a beneficiary may claim the excess deductions of a terminating estate or trust notwithstanding the suspension of miscellaneous itemized deductions under Section 67(g). In connection with the drafting of new regulations, Treasury and the IRS are seeking public comments on whether amounts deductible under Section 642(h)(2) of the Code should be analyzed separately from other miscellaneous itemized deductions when applying Section 67 of the Code. Notice 2018-61 does not provide a timeframe for when Treasury and the IRS may issue new regulations.

ASSET PROTECTION

52. Georgia House Bill 441 (2018)

Georgia Governor vetoes domestic asset protection trust legislation

In late March 2018, the Georgia House of Representatives (by a vote of 103-56) and the Georgia Senate (by a vote of 43-6) passed HB 441, which would have made Georgia the 18th state to permit self-settled domestic asset protection trusts or DAPTs. Currently, 17 states — Alaska, Delaware, Hawaii, Michigan, Mississippi, Missouri, Nevada, New Hampshire, Ohio, Oklahoma,

Rhode Island, South Dakota, Tennessee, Utah, Virginia, West Virginia and Wyoming — have enacted DAPT-enabling legislation. Georgia, however, did not join their ranks, because on May 8, Gov. Nathan Deal vetoed HB 441.

Under current Georgia law, spendthrift provisions in a trust that shield the trust's assets from certain creditors are enforceable if the trust is settled by someone other than the trust's beneficiaries. HB 441 would have gone further, as the other DAPT states have done, by providing creditor protections to an irrevocable trust even if the settlor is also a beneficiary of the trust.

Deal indicated in his veto statement that he was open to further negotiations on this issue. However, the version of the bill Georgia's governor rejected already contained remarkably large gaps in the creditor protection that HB 441 supposedly would have provided. Tort, child support, and spousal claims, for instance, were completely exempted. Secured creditors also enjoyed an exemption for assets specifically pledged by a debtor. That left credit card and medical claims as perhaps the only types of debt that HB 441 would have allowed a settlor to avoid.

It is also worth noting that, with this veto, Deal has strengthened Georgia's standing as one of the most creditor-friendly states in the country. Further, in 2015, Georgia enacted the Uniform Voidable Transfer Act (UVTA). Under the UVTA, creditors may avoid certain transfers made by an insolvent debtor by using the less-onerous preponderance-of-the-evidence standard, as opposed to the clear-and-convincing standard used in many jurisdictions. The UVTA also makes it more difficult for debtors, and the trusts they settle, to start the statute-of-limitations clock for allegedly voidable transfers.

Deal's veto of HB 441 appears to continue Georgia's generally creditor friendly legal tradition.

53. Toni 1 Trust v. Wacker, 413 P.2d 1199 (AK 2018)

Alaska Supreme Court determines that Alaska state courts do not have exclusive jurisdiction over fraudulent transfer actions under AS 34.40.110(k)

Donald Tangwall sued William and Barbara Wacker in Montana state court in 2007. The Wackers counterclaimed against Tangwall, his wife, Barbara Tangwall, his mother-in-law, Margaret "Toni" Bertran, and several trusts and businesses owned or run by the Tangwall family. As a result, several default judgments were entered against Donald Tangwall and his family.

In 2010, before the issuance of the last of the default judgments, Toni Bertran and Barbara Tangwall transferred parcels of real property to an Alaskan trust called the "Toni 1 Trust" which was an Alaska self-settled domestic asset protection trust." The Wackers filed a fraudulent transfer action under Montana law in Montanan state court alleging that the transfers were fraudulent and default judgments were entered against Barbara Tangwall, the Toni 1 Trust, and Toni Bertran.

After the issuance of the fraudulent transfer judgments by the Montana court, the Wackers purchased Barbara Tangwall's one half interest in one of the parcels at a sheriff's sale in partial

satisfaction of their judgment against Donald Tangwall and the family. Before the Wackers could purchase the remaining half interest, Toni Bertran filed for Chapter 7 bankruptcy in Alaska. As a result, her interest in the property in the Toni 1 Trust was subject to the jurisdiction of the federal bankruptcy court.

In December 2012, Donald Tangwall, as trustee of the Toni 1 Trust, filed a complaint in the bankruptcy court alleging that the service on the trust in the Montana fraudulent transfer action was defective, which rendered the judgment against the trust void. However, rather than litigate the issue of service in Montana, the bankruptcy trustee brought a fraudulent transfer claim against Tangwall under the federal bankruptcy fraudulent transfer statute. The bankruptcy court entered a default judgment against Tangwall, which judgment was sustained upon appeal.

Tangwall then sought relief in Alaska state court in which he argued that AS 34.40.110 granted Alaska courts exclusive jurisdiction over any fraudulent transfer actions against the trust. On this basis, Tangwall sought a declaratory judgment stating that all judgments against the trust from other jurisdictions were void and that no future actions could be maintained against the trust because the statute of limitations had run.

The Alaska Superior Court dismissed this complaint and Tangwall appealed. The Alaska Supreme Court found that AS 34.40.110(k) could not limit the scope of the jurisdiction of other states. Citing Tennessee Coal, Iron and Railroad Company v. George, 233 U.S. 354 (1914), the Court held that states are not constitutionally compelled to acquiesce to sister states' attempts to circumscribe their jurisdictions over actions. It stated that Tennessee Coal held that the Full Faith and Credit Clause of the United States Constitution does not compel states to follow another state's statutes claiming exclusive jurisdiction over suits based on a cause of action "even though the other state created the right of action." The Court did acknowledge that the Alaska legislature attempted to grant Alaska courts exclusive jurisdiction over claims against an Alaska self-settled domestic asset protection trust. It also acknowledged that several other states had similar statutes and that similar statutes do restrict their jurisdiction. However, the court found that under Tennessee Co, the assertion of exclusive jurisdiction did not render a fraudulent transfer judgment against an Alaskan trust from a Montana court void for lack of subject matter jurisdiction.

In addition, the court found that it could not grant Tangwall relief under federal judgment. It noted that Tennessee Coal only addressed the state's ability to restrict the jurisdiction of sister states. However, Marshall v. Marshall, 547 U.S. 293 (2006), concluded that state efforts to limit federal jurisdiction were invalid even though the state created the right of action that gave rise to the suit. It noted that AK 34.40-110(k) purported to grant Alaska courts exclusive jurisdiction over all fraudulent transfer claims against Alaska self-settled domestic asset protection trusts. Because 28 U.S.C. § 1334(a) gives federal courts' jurisdiction over some of these claims, the Alaska law conflicted with federal law to the extent that it was impossible to comply simultaneously with both. Consequently, under the Supremacy Clause of the Constitution, state courts are precluded from limiting federal jurisdiction. Therefore, relief could not be granted to Tangwall from the federal judgment.

54. <u>Olson v. Marshack,</u> ___ F. Supp. 3d ___ (C.D. Cal. 2018)

U.S. District Court declines to approve settlement of bankruptcy trustee with respect to offshore trust

In 2010, Jana W. Olson was sued in California Superior Court by Passport Management LLC. Within a month of the service of the lawsuit, Olson transferred her beneficial interest in a self-settled Cook Islands offshore asset protection trust from herself to her two minor children for no consideration. This transfer had the appearance of a fraudulent transfer. Subsequently, Olson filed a petition for bankruptcy. Passport Management LLC became the primary creditor of the bankruptcy estate.

At some point, Olson agreed to repatriate the money in the self-settled Cook Islands trust and a stipulated order was entered by the bankruptcy court directing Olson to do so. The bankruptcy court's order specifically required repatriation but did not decide if the money was the property of the bankruptcy estate.

Olson then, according to the district court, proceeded to disobey the bankruptcy court's order by sabotaging the repatriation effort with a letter designed to convince the Cook Islands trustee that her request to repatriate the money was made under duress. As a result, apparently, the Cook Islands trustee refused to repatriate the money. The bankruptcy court then jailed Olson for more than a year for civil contempt. Eventually, the bankruptcy trustee decided that jail was not going to convince Olson to repatriate the funds in the trust from the Cook Islands. The bankruptcy trustee then negotiated an agreement with Olson and Olson's father and Olson's brother, as trustee of a new California trust with the two minor children as beneficiaries, under which the money would be returned to California with approximately 80 percent going to the bankruptcy estate and 20 percent to the California trust.

After the repatriation of the funds to California, the bankruptcy trustee moved for approval of the compromise agreement before the bankruptcy court. Passport Management opposed the motion claiming that there was no authority to disburse property of the bankruptcy estate in contravention of the priority rules and that, in any event, there was no reason to allow Olson effectively to be rewarded for her contempt. Passport Management LLC also argued that other pressure could have been brought to bear before a compromise was struck that allowed Olson or her family to retain part of the funds.

The bankruptcy trustee argued that the agreement was the only way to get property back into the reach of the United States court and that 80 percent was better than getting nothing at all. The trustee also believed that the fraudulent transfer claim could have been easily won, but that subsequent collection would have been virtually impossible because of the difficulty of seeking collection in the Cook Islands. As a result, the bankruptcy court granted the motion to approve the compromise, but declined to determine whether the trust funds held in the Cook Islands were always the property of the bankruptcy estate.

The district court rejected the compromise. First, the court said that without a judgment avoiding the transfers, the Cook Islands funds were not a part of the bankruptcy estate at the time of the

petition. The transfers would have to be formally avoided through a fraudulent transfer claim to make the funds part of the bankruptcy estate. In addition, the bankruptcy court had no equitable duty to approve the compromise after Olson and her family arranged for the repatriation money in reliance on the settlement. This effectively minimized the independent role of the bankruptcy court in the process. The court also agreed with Passport Management that a benefit to Olson's minor children was an indirect benefit to Olson herself as the money set aside in trust was money that Olson did not have to pay for her children's welfare. The court then rejected the argument of the bankruptcy trustee that the minor children might be individually liable for their mother's debt as beneficiaries of the trust. The court noted that the normal rule is that beneficiaries are not liable for the wrongful acts of the trust. As a result, the district court rejected the settlement agreement.

FIDUCIARY CASES

55. **Ajemian v. Yahoo!, Inc., 84 N.E. 3d 766 (Mass. 2017), petition for cert. docketed sub nom. Oath Holdings, Inc. v. Ajemain (U.S. Jan. 19, 2018 (No. 17-1005)**

The Stored Communications Act (the "SCA") does not prevent Yahoo!, Inc. ("Yahoo") from voluntarily disclosing emails from a decedent's account to the decedent's personal representatives at the request of the personal representatives; it remains to be settled whether the SCA compels Yahoo to do the same

John Ajemian died intestate, and his siblings, Robert Ajemian and Marianne Ajemian, were appointed as his personal representatives. Robert and Marianne asked Yahoo to provide access to the contents of John's e-mail account. Yahoo refused to release the contents of the account, although they did provide "subscriber information" upon Robert and Marianne obtaining a court order mandating disclosure to the account holder's personal representatives.

Robert and Marianne filed a complaint in the Probate and Family Court seeking a judgment that they were entitled to unfettered access to the messages in the account. Yahoo filed a cross motion for summary judgment arguing that the SCA prohibited the requested disclosure, and, even if it did not, Yahoo was permitted to deny access to, or even delete the contents of, the account at its sole discretion based on the service contract entered into at the time the e-mail account was created.

The judge granted Yahoo's motion for summary judgment solely on the basis that the SCA barred Yahoo from complying with the requested disclosure. Robert and Marianne appealed to the Massachusetts Appeals Court, and the Supreme Judicial Court of Massachusetts transferred the case to themselves as a matter of first impression.

The SCA prohibits entities that provide "service[s] to the public" from voluntarily disclosing the "contents" of stored communications unless certain statutory exceptions apply. The "agency exception" allows a service provider to disclose the contents of stored communications "to an addressee or intended recipient of such communications or an agent of such addressee or intended recipient." The "lawful consent exception" allows disclosure "with the lawful consent of the originator or an addressee or intended recipient of such communication."

The Supreme Judicial Court of Massachusetts ruled that the SCA does not prohibit Yahoo from voluntarily disclosing the contents of an e-mail account to the personal representatives of the account holder's estate, because the lawful consent exception applies.

The Court found that the agent exception does not apply because personal representatives are not agents of the decedent, as they cannot be controlled by the decedent. However, the lawful consent exception does apply such that the personal representatives of a decedent can give lawful consent to release of the content of the account. The Court reasoned that to find otherwise would result in a class of digital assets—stored communications—that could not be marshalled by personal representatives. The Court found that this was not the intent of the SCA. Therefore,

based on the Court's statutory interpretation analysis, personal representatives are capable of giving "lawful consent" to the disclosure on behalf of the account holder, and "actual consent" by the decedent is not required to qualify for the "lawful consent exception" under the SCA.

Because the lawful consent exception applies, Yahoo is not prevented by the SCA from releasing the contents of the account to the personal representatives. The Supreme Judicial Court of Massachusetts remanded the issue of whether Yahoo was compelled to release the contents of the account to the Probate and Family Court, but strongly signaled that if the lower court were to find that Yahoo was not compelled to release the contents, the Supreme Judicial Court of Massachusetts would overturn that ruling and compel Yahoo to release the contents of the account.

56. **Laborers' Pension Fund v. Miscevic, No. 17-2022 (7th Cir. Jan. 29, 2018)**

ERISA does not preempt the Illinois slayer statue, and the Illinois slayer statute applies where the deceased was killed by an individual found not guilty by reason of insanity

Evidence produced at her criminal trial showed that Anka Miscevic killed her husband, Zeljko Miscevic, in January 2014; however, she was found not guilty by reason of insanity. Despite the finding that she was responsible for her husband's death, Anka then claimed she was entitled to her deceased husband's pension plan, which was governed by federal ERISA law. A claim was also made on behalf of their minor son for the benefits. Their minor son was awarded the benefits from the pension plan. Anka appealed.

Illinois has a "slayer statute," which provides that "a person who intentionally and unjustifiably causes the death of another shall not receive any property, benefit, or other interest by reason of the death." However, neither federal ERISA law nor the pension's governing documents contains an express slayer provision; therefore, if federal law governs, the named beneficiary would receive the assets, despite the operation of a slayer statute under state law.

On appeal, the Court of Appeals for the Seventh Circuit upheld the interpretation that a slayer is precluded from obtaining the benefits payable under the decedent's pension plan even if they were found not guilty by reason of insanity. The Court reasoned that slayer statutes are traditionally an area of state regulation, and it rejected Anka's argument that Congress intended to preempt the slayer statutes through ERISA. ERISA was enacted after it was well established that an individual who kills another individual cannot benefit as a result of that death. Therefore, Congress could have clearly stated that it intended to change that result in certain situations, but their failure to explicitly state that intent results in a determination that it was not their intent.

Further, the Court held that Illinois' statute that provides that "a person who intentionally and unjustifiably causes the death of another" is broad enough to encompass a situation where an individual is found not guilty by reason of insanity. They deferred to state law decisions to interpret the statute. Anka argued that the killing was justifiable because she was found not guilty. The Court rejected this argument on the grounds that an insanity defense is an "excuse"

defense, not a "justification" defense. The decision rests on lower court decisions interpreting the statute, and therefore the Court does acknowledge that the interpretation may be different in other states.

57. Lynch v. Barba, 2018 WL 1613834, C.A. No. 12083-MG (Del. Ch. Ct. 2018)

Trustee is entitled to summary judgment when beneficiary cannot substantiate his breach of fiduciary duty allegations and has waited too long to file his lawsuit against the trustee

Ethel M. Lynch died in August of 2010. She named her daughter, Rhonda Barba as executor of her estate and trustee of two testamentary trusts. Rhonda predeceased Mrs. Lynch, so Rhonda's husband, Francis Barba, qualified as the named successor executor and trustee.

Mrs. Lynch had transferred her property to a Revocable Trust which was to be distributed at her death, one-half to a Special Needs Trust for her husband, Mr. Lynch, and the remainder was to remain in the Revocable Trust for the benefit of Rhonda. Upon Rhonda's death, the Revocable Trust provided the principal of the Special Needs Trust would be distributed in accordance with Rhonda's testamentary power of appointment or to her surviving issue per stirpes. The beneficiaries after Mrs. Lynch's death are Mr. Lynch and Rhonda's two sons, Matthew and Eric Barba.

Mr. Barba and Mr. Lynch did not have a good relationship prior to Mr. Barba serving as Trustee for Mr. Lynch's Trust, and this additional relationship only exacerbated their disagreements. Mr. Lynch filed a 78 count Complaint alleging Mr. Barba did not act in good faith while serving as executor for Mrs. Lynch's estate and as trustee of the Special Needs Trust.

Among his many complaints, Mr. Lynch claimed Mr. Barba breached the fiduciary duties he owed Mr. Lynch as trustee of the Special Needs Trust by selling trust/estate property for less than its fair market value, refusing to change the name of the trust to remove "special needs," improperly moving and converting trust assets for personal use, failing to communicate with the beneficiary, failing to make distributions when requested, wasting trust assets and failing to provide accountings or other required reports as requested.

Mr. Barba filed a Motion for Summary Judgment requesting the trial court dismiss Mr. Lynch's Complaint, as there were no disputed facts to support the allegations that Mr. Barba had failed to meet his fiduciary obligations. Mr. Barba also asserted Mr. Lynch's claims were time barred and that the doctrine of laches prevented Mr. Lynch from asserting them. Both Mr. Barba and Mr. Lynch requested that the Special Needs Trust be terminated and all remaining assets be distributed to Mr. Lynch.

A plaintiff has the burden of proving his allegations. A plaintiff who fails to present specific evidence of a breach of duties owed by a trustee will not be successful.

Patricia Griffin, a Master in the Court of Chancery of Delaware, submitted a report to the Chancery Court containing her recommendations for action on the pending Motion for Summary

Judgment. Overall, the Master found that Mr. Barba did not violate his fiduciary duties as trustee.

The Will granted the executor and trustee of the Special Needs Trust broad fiduciary powers along with the ability to hold or dispose of property in the trustee's discretion. When assessing the appropriateness of Mr. Barba's actions as trustee, Delaware applies a prudent investor standard. When the trustee acts with skill, care, diligence and prudence in light of the circumstances, they will not be found to violate their fiduciary duty to the beneficiary as a result of their actions.

In reviewing Mr. Barba's actions, the Master found that Mr. Lynch presented insufficient evidence to support any of his claims for breach of fiduciary duty. Mr. Barba sold the real property held in the estate for their appraised values and Mr. Lynch did not provide any factual support that the properties were sold for less than their fair market value. The Master also found that the Special Needs Trust expressly authorized employing and compensating advisors for the proper administration of the trust. Mr. Barba also demonstrated his compliance with the Trustee's duty to keep accurate records contrary to the assertion of Mr. Lynch.

With respect to the exercise of Mr. Barba's discretion, the Master held that to determine if Mr. Barba breached his duties to Mr. Lynch, she had to determine whether the funds distributed to the beneficiary were consistent with the authority provided by the Special Needs Trust and Delaware law, not whether Mr. Lynch received all of the payments he requested. Because Mr. Barba was granted the sole and uncontrolled discretion to make payments from the trust to Mr. Lynch, the Master found that his failure to agree to every request from Mr. Lynch did not itself constitute a breach of the trustee's duty.

The Master further found that even if Mr. Lynch had one or more valid claims, laches would bar his claims. To support the affirmative defense of laches, the defendant must prove the claimant had knowledge of the claim, the claimant unreasonably delayed in bringing the claim and that delay resulted in prejudice to the defendant.

The Master found that Mr. Lynch knew in September 2011 about the transfers of property and actions he complained of during the administration of Mrs. Lynch's Estate. The inventory for Mrs. Lynch's Estate was filed in March 2011 and the final accounting was filed in September 2011, a copy of which was sent to Mr. Lynch. Mrs. Lynch's estate closed in December, 2011.

Mr. Lynch did not assert his claims until March 2016, over four and a half years after the claim arose. By that time the Estate was closed and all property had been distributed. Therefore, if Mr. Lynch were allowed to proceed, the Estate would have to be reopened and beneficiaries would have to find a way to reimburse the Estate to satisfy Mr. Lynch's claims. On these facts, the Master found that all three requirements for laches were satisfied, barring Mr. Lynch's claims.

Lastly, the Master addressed Mr. Lynch's and Mr. Barba's request to terminate the Special Needs Trust and to allow distribution of the assets to Mr. Lynch. Delaware law allows a court to terminate a trust if all beneficiaries consent and the court determines the settlor's objectives or

purpose for the trust has become impossible to achieve, administration is difficult or impractical, and/or continuing the trust is not in the best interest of the beneficiaries.

The Master found that termination of the Special Needs Trust was appropriate because of the broad trust purposes to benefit Mr. Lynch and because of the unlikelihood of locating a successor trustee willing to serve. Mr. Barba was not willing to continue to serve as trustee and the successor trustee named in the trust instrument also had declined to serve.

58. **Bullard v. Hoffman (In re Mayette E. Hoffman Living Trust U/A dated August 4, 1997), 812 S.E.2d 401 (N.C. Ct. App. 2018)**

A trustee's egregious conduct is not a prerequisite to awarding attorney's fees under the UTC in a judicial proceeding involving the administration of a trust

Kimberli Bullard and James Hoffman were co-trustees of a trust for the benefit of their father. The primary asset of the trust was the father's residence. When their father was moved to a nursing home, the father's attorneys notified Kimberli and James of their responsibility as fiduciaries to co-manage the property, including dealing with repair and maintenance of the residence. Kimberli and James could not agree on management of the property and the residence was left vacant, bills were unpaid, insurance lapsed and the property generally deteriorated.

After approximately two years, Kimberli sent James a letter alleging James' various breaches of fiduciary duty and requesting that he voluntarily resign as co-trustee. James acknowledged receipt of the letter but took no other action. Kimberli then petitioned the Guilford County Superior Court to remove James as co-trustee. While the removal case was pending, there was a tenant interested in leasing the property but James refused to sign the lease. Upon petition by Kimberli, the Clerk of the Superior Court entered an order approving the lease.

After the Clerk removed James as co-trustee, Kimberli filed a petition for attorney's fees in the amount of $26,096.70. The Clerk awarded $7,243 in attorney's fees as reflective of the fees incurred during the time that the petition to remove James as co-trustee was pending. The Clerk found that James' actions during that period were "egregious and obstructionist" in a manner that warranted an award of attorney's fees. However, the attorney's fees incurred outside of that period were denied as being irrelevant to James' "egregious and obstruction behavior." James' appeal of this fees award to the Guilford County Superior Court was denied. James appealed this decision to the North Carolina Court of Appeals.

Under the North Carolina Uniform Trust Code a court may award costs and expenses, including reasonable attorney's fees, as provided in the General Statutes. In turn, the General Statutes permit the court to apportion costs amongst the parties in the court's discretion. At common law, litigation expenses were generally only chargeable against the other party in the case of egregious conduct, such as bad faith or fraud.

The North Carolina Court of Appeals denied James' appeal and upheld the award of attorney's fees. The Court of Appeals reasoned that the common law principle requiring egregious conduct for an award of attorney's fees is not required by the applicable statutes, which leave the award

to the court's discretion. The Court of Appeals further held that even if egregious conduct were a prerequisite to an award of attorney's fees, James' conduct while the removal action was pending was, in fact, egregious. James was aware that the trust property was continuing to lose value while vacant, but he refused to take corrective action. Therefore, the Clerk did not abuse her discretion in her award of attorneys' fees to Kimberli.

59. **<u>In Estate of Forgey</u>, 298 Neb. 865 (2018)**

Nebraska Supreme Court awards damages and legal fees for trustee's failure to inform and report

This dispute involved, among other related matters, the proper measure of damages for failing to provide an accounting for the Glenn G. Forgey Revocable Trust ("Trust"). The grantor of the trust, Glenn G. Forgery ("Grantor") died in 1993.

Under the terms of the Trust, following the Grantor's death and payment of the Grantor's debts, funeral expenses, estate expenses, and federal estate taxes, the remaining assets of the Trust were to be divided into separate trusts for the benefit of each of the Grantor's surviving children and the descendants of the Grantor's children who did not survive him. The Grantor had three surviving children: Lyle A. Forgey ("Lyle"), Bessie I. Forgery-McCoy ("Bessie"), and Wayne Forgey ("Wayne"). Wayne died before the lawsuit commenced.

The trust instrument named Lyle sole trustee and gave him broad discretion to manage the Trust. The Trust instrument also required Lyle to provide an annual accounting to the beneficiaries.

Lyle failed to file timely the Grantor's federal estate tax return, resulting in the assessment of interest and penalties. Because the Trust owned mostly illiquid assets and none of the family members wanted to sell Trust assets, Lyle made an election under the Internal Revenue Code to pay estate taxes on an installment basis. The installment payment of estate taxes contributed to a significant delay in terminating the Trust.

The Trust's primary assets consisted of agricultural land, stock in a small local bank, and cash. The Trust instrument required allocation of all the bank stock to Lyle's share. Before the Grantor's death, the Grantor, Lyle, and Wayne conducted jointly a cattle ranching business on the land and divided the profits 20 percent to the Grantor, 45 percent to Lyle, and 35 percent to Wayne. Although the Grantor owned the land, Lyle and Wayne did not pay rent to the Grantor. Lyle and Wayne continued operating the ranching business in the same manner after the Grantor's death, but paid the Grantor's 20 percent profit share to the Trust.

In 2013, Wayne's surviving spouse Marvel Forgey ("Marvel") and her children brought suit against Lyle because after 20 years the Trust still had not been divided into separate shares. These plaintiffs also alleged various breaches of fiduciary duty and sought to remove Lyle as trustee. Among other claims, Marvel and Bessie contended that Lyle breached his fiduciary duties by failing to charge rent to himself and Wayne for use of the land in the ranching business. They also contended that Lyle breached his fiduciary duties by failing to timely file the federal estate tax return and by failing to render accounts as required by the Trust instrument.

The trial court ultimately dismissed most of the breach of fiduciary duty claims, but ordered the termination and division of the Trust. The court determined what the values of the Trust assets were at the time of the Grantor's death. The court assigned assets to each of the shares based on their values in 1993. Under this method, Lyle's share received all the bank stock and Wayne's and Bessie's shares each received one-half the land. The court used cash and other assets to equalize the value of the shares. The court then allocated income and expenses to each share over the 20-year period based on the asset to which the income and expenses related. For instance, Lyle's share received the benefit of all the bank stock dividends.

Marvel appealed the trial court's order, contending, among other things, that the trial court should have awarded Marvel and Bessie attorneys' fees and that the trial court erred in failing to assess damages against Lyle for failing to render an accounting.

Nebraska law before 2005 required a trustee to keep the beneficiaries reasonably informed of the trust and its administration. After the enactment of the Uniform Trust Code in 2005, Nebraska law required a trustee to send the beneficiaries, at least annually, a report of the trust property, liabilities, receipts, and disbursements. The Trust instrument also required the trustee to account to the beneficiaries. Normally, an accounting is the appropriate remedy for failing to inform and report to the beneficiaries.

Typically, a trustee who successfully defends against claims for breach of fiduciary duty may reimburse himself for the attorneys' fees from the trust. When the trustee creates the circumstances that permit the beneficiaries to question the trustee's actions, the trustee should bear his own attorneys' fees.

The Nebraska Supreme Court held that because Lyle's failure to keep the beneficiaries informed caused the misunderstandings and complications that led to the litigation, an accounting was not a complete remedy. In the Court's opinion, Bessie failed to raise with Lyle the issue of rent for the agricultural land because she had no information about the ranching business or the value of the land. The Court therefore ordered that Lyle transfer to Bessie's share an amount equal to one-half the rent he should have collected from himself and Wayne.

The Court also ordered Lyle to transfer an amount equal to the assessed penalties and interest resulting from the failure to timely file the estate tax return equally to Bessie's and Wayne's shares. Finally, the Court found that the trial court should have awarded the plaintiffs their attorneys' fees. Without an award of attorneys' fees, there would be no consequence for Lyle failure to inform and report. Furthermore, Bessie and Marvel had expended considerable funds enforcing their statutory right to an accounting. In the Court's opinion, failing to reimburse Bessie and Marvel would produce an inequitable result.

60. **<u>Morgan v. Superior Court of Orange County</u>, 23 Cal. Rptr. 3d 647 (Cal. App. 2018)**

California court holds that predecessor trustee cannot assert the attorney-client privilege against a successor trustee and that any provision of a trust instrument seeking to do so violates public policy

This case arose during litigation between Thomas Edward Morgan, III ("Morgan"), the trustee and a beneficiary of the Amended and Completed Restated Beverly C. Morgan Family Trust dated November 6, 2013 ("Trust"), and Nancy Morgan Shurtleff, John Evans Morgan, and Nancy Morgan Shurtleff's daughters Kathleen Shurtleff and Jessica Shurtleff (collectively, the "Shurtleffs"), who are beneficiaries of the Trust. Morgan became sole trustee of the Trust following the death of the settlor, Beverly C. Morgan, in January 2014. Shortly after Morgan became trustee, the Shurtleffs filed a petition in the Probate Court for Orange County, California ("Probate Court"), seeking reformation of the Trust and removal of Morgan as trustee. The litigation continued for three years.

In April 2017, the Probate Court removed Morgan as trustee of the Trust and named Bruce and Lee Ann Hitchman (the "Hitchmans") as successor co-trustees. The Probate Court ordered Morgan to turn over to the Hitchmans all communications he made in his capacity as trustee of the Trust. Morgan objected to disclosing certain communications with his attorney, contending that both the attorney-client privilege and the terms of the Trust instrument barred their disclosure. The section of the Trust instrument in question provided that all communications with legal counsel "shall be absolutely protected and free from any duty or right of disclosure to any successor Trustee or any beneficiary and any duty to account."

The Probate Court held that the terms of the Trust prohibiting disclosure of all communications with legal counsel violated California public policy and entered an order compelling Morgan to disclose the privileged communications to the Hitchmans. The Probate Court's order explicitly prohibited the Hitchmans from disclosing these communications to the Shurtleffs. Morgan sought a writ of mandamus from the Fourth District Court of Appeal ("Court") stating that the Probate Court judge exceeded his authority in issuing the order.

Under California law, a trustee who seeks legal advice on behalf of a trust may assert the attorney-client privilege against a beneficiary or any third person with respect to any communications with the trustee's legal counsel. This privilege, however, vests in the office of trustee and not in the individual or entity serving as trustee. Accordingly, a former trustee must turn over all communications, including privileged communications, to a successor trustee upon request. The successor trustee can continue to assert the attorney-client privilege against the beneficiaries of the trust. A trustee who seeks legal advice regarding a charge of breach of fiduciary duty may hire a separate lawyer and pay the lawyer out of the trustee's personal funds.

Under California law, a trust instrument cannot absolve a trustee from liability for intentional misconduct, gross negligence, or reckless indifference. Privileged communications may bear on a successor trustee's determination of whether a predecessor trustee acted with intentional misconduct, gross negligence, or reckless indifference. Accordingly, a trust provision barring a

predecessor trustee from disclosing privileged communications to a successor trustee is unenforceable.

The Court upheld the Probate Court's order requiring Morgan to turn over the privileged communications to the Hitchmans. The provisions of the Trust instrument barring disclosure of privileged communications to successor trustees violated California public policy and were unenforceable. Because Morgan did not distinguish between communications with his attorney on behalf of the Trust and communications with his attorney to protect himself from liability, and because Morgan paid his attorney using Trust funds, California law required him to turn over the privileged communications to the Hitchmans. Furthermore, the Probate Court correctly applied California law in barring the Hitchmans from disclosing any privileged communications to the Shurtleffs.

61. **Carberry v. Kaltschmid, 2018 WL 2731898 (Cal. 2018)**

Trust protectors do not have a general right to information allowing them to compel trust accountings

The terms of a trust provided for a "trust protector" who held certain powers in a "fiduciary capacity." The trust protector was not a beneficiary, and the trust instrument did not explicitly grant the trust protector the right to compel an accounting. The trust protector filed a probate "Petition for Order Compelling Co-Trustees to Account and to Provide Information" in the wake of a dispute between the trustees and beneficiaries that, at the time of the trust protector's petition, was in the process of being settled. No trustee or beneficiary joined or supported the trust protector's petition.

The California Probate Code requires trustees to provide accountings to the beneficiaries of a trust with a present interest in either principal or income (§ 16062(a)). Further, a trustee or beneficiary may seek a court order to compel a trustee to account to a beneficiary (§ 17200(a) & (b)(7)(C)). The California Probate Code does not grant such rights to trust protectors.

The Probate Division of the San Mateo County Superior Court denied the trust protector's petition for an accounting, ruling that the trust protector lacked standing. The trust protector appealed. The California Court of Appeal, First District, Division 5, affirmed and awarded appellate costs, but not sanctions, to the respondents.

Although California law provides trust beneficiaries with the right to compel an accounting, the trust protector was not a beneficiary of the trust. Further, the terms of the trust did not give the trust protector the right to compel an accounting. Therefore, the trust protector did not have a right to compel an accounting and lacked standing to bring his "Petition for Order Compelling Co-Trustees to Account and to Provide Information".

62. **<u>Doermer v. Oxford Fin. Grp., Ltd.</u>, 884 F.3d 643, 647 (7th Cir. 2018)**

When there are multiple co-trustees, a single trustee does not have capacity to bring an action on behalf of a trust, and a beneficiary cannot sue on behalf of the trust

Richard Doermer and Kathryn Doermer Callen are the only children of Richard T. and Mary Louise Doermer. They are the beneficiaries of a multi-million dollar trust that their parents established for their benefit and the benefit of their children (the "Trust"). The Trust currently has three trustees, Richard, Kathryn, and Bankers Trust, a corporate trustee. In 2010, Richard and Kathryn had an "irreconcilable" dispute regarding how to manage and invest the Trust assets. Kathryn hired Oxford Financial Group ("Oxford"), to advise her in handling the Trust and to help resolve the problems with her brother. The Trust paid Oxford's fees.

In 2012, Oxford recommended that the co-trustees divide the Trust into two, one trust for Kathryn and her descendants and one trust for Richard and his descendants. As part of this plan, the Trust's situs was moved from Indiana to South Dakota. The siblings could not agree on how to divide the assets and Kathryn refused to sign the agreement. Richard petitioned a South Dakota state court to divide the Trust; however, the court denied the request.

In July 2016, Richard sued Oxford in Illinois state court on behalf of the Trust for breach of fiduciary duty, negligence, gross negligence and willful and wanton misconduct. Richard states that the reason Kathryn refused to sign the agreement was the negligent advice she received from Oxford. Because the Trust was not divided, Richard was unable to pursue his high-risk, high reward investment strategy. If the Trust had been divided, Richard believes his half would have earned an additional $2 million in reasonable investments opportunities. Richard sued Oxford in his capacity as both a co-trustee and a beneficiary of the Trust. The complaint identified Kathryn as an "involuntary plaintiff"; however, besides sending her a letter and a copy of the complaint, she was not joined as a party.

Oxford removed the case to federal court based on diversity jurisdiction and filed a Motion to Dismiss the Complaint. The District Court granted the Motion to Dismiss, as Richard could not sue in his capacity as co-trustee, because both state law and the trust agreement required a majority of the co-trustees to consent to the lawsuit. Additionally, Richard could not sue Oxford as a beneficiary, because state law prohibits a trust's beneficiary from suing a third party on behalf of the trust.

Richard appealed challenging both rulings and additionally arguing that the removal of the case to federal court was improper. Richard claimed the District Court lacked subject matter jurisdiction, arguing that Kathryn's presence in the case as an "involuntary plaintiff" destroyed the diversity jurisdiction that would make the removal proper.

Illinois law requires consent of a majority of the trustees to act on behalf of the trust, including filing litigation. A trust's beneficiary may not sue a third party on behalf of a trust unless the trustee could maintain an action against a third party but improperly refuses to sue.

On appeal, the United States Court of Appeals, Seventh Circuit, upheld the dismissal of the case. The Seventh Circuit first affirmed that the District Court did have valid subject matter jurisdiction because there was diversity between the plaintiff and the defendant. The Seventh Circuit evaluated the use of "involuntary plaintiff" in both Illinois (where the lawsuit was filed) and South Dakota (where the situs of the trust was located). If Kathryn was an "involuntary plaintiff" then diversity jurisdiction was destroyed, as she and Oxford are both citizens of Indiana. The Seventh Circuit stated that there is no such thing as an "involuntary plaintiff" in Illinois, and even if the case was decided under South Dakota law, an involuntary plaintiff can only arise when that person's presence is essential for proper adjudication of the case.

Richard also argued that the Trust was the real party in interest and the Trust had the citizenship of every co-trustee including Kathryn. The Court rejected this argument because when a trustee "files a lawsuit or is sued in her own name, her citizenship is all that matters for diversity purposes."

In evaluating the claims, the Seventh Circuit stated that a plaintiff's capacity to sue on behalf of a trust is determined by the state where the federal district court is located. While the Seventh Circuit used Illinois law, it stated that the outcome would not change if South Dakota law applied. The Seventh Circuit confirmed that Illinois law barred Richard from suing Oxford in his capacity as co-trustee, because state law required the consent of a majority of trustees to act on behalf of the Trust. Additionally, the Trust agreement also required a majority of co-trustees to act on behalf of the Trust and because neither the corporate trustee nor Kathryn consented to the lawsuit, Richard did not have standing to sue as a trustee.

Additionally, the Court affirmed that Richard could not sue as a beneficiary because a beneficiary may not sue a third party on behalf of a trust unless the trustee improperly refuses to file suit. An improper refusal only occurs when there is a breach of the trustee's fiduciary duties to bring the claim. Richard's Complaint did not state that either Kathryn or the corporate trustee breached any fiduciary obligation by not joining the suit and therefore failed to establish a basis allowing him to bring this suit rather than the trustees. The Seventh Circuit accordingly affirmed the dismissal of the case.

63. **Estate of Lee, 2018 WL 2374116 (Texas 2018)**

The spendthrift provisions of a testamentary trust rendered invalid, for the purposes of a standing analysis, the terms of an agreement between former beneficiaries of the trust

Testatrix Lucy Lee ("Lucy") established a testamentary trust (the "Trust") under the terms of her will (the "Will") for the lifetime benefit of her son, Jack O'Guinn ("O'Guinn"), and upon his death for the benefit of her step-grandson, Michael Douglas Lee ("Lee"), and grandson Jack Lindsay O'Guinn ("Jack"). Lucy modified her Will by a first codicil (the "First Codicil"), which named Lucy's niece, Mary Elizabeth Whitten ("Whitten") as the Trust's sole remainder beneficiary in place of Lee and Jack. Lucy later executed a second codicil (the "Second Codicil"), changing her plan and leaving her entire estate to O'Guinn outright and free of trust.

After Lucy's death, Whitten and Lee entered into an agreement (the "Agreement") pursuant to which Lee would contest probate of the Second Codicil in exchange for Whitten's promise to share 40% of her share under the First Codicil should Lee's contest of the Second Codicil be successful. The terms of the Will, republished by the First Codicil, provided that the beneficiaries held their interests subject to a spendthrift trust.

To have standing to contest a will or codicil, a party must be an "interested person," defined under Texas law as an "heir, devisee, spouse, creditor, or any other having a property right in or claim against an estate being administered" (Tex. Estates Code Ann. § 22.018(1)). Status as a former remainder beneficiary under the terms of a testamentary trust does not satisfy this definition. Further, because the spendthrift provisions of a trust may invalidate, for the purposes of a standing analysis, contractual agreements made between a trust's beneficiaries, being a party to an agreement with a trust beneficiary does not necessarily cause someone to be an "interested person" with respect to the trust or to the will that created the trust.

The County Court of Gregg County, Texas, denied Lee's petition contesting probate of the Second Codicil, ruling that Lee lacked standing. Lee appealed. The Court of Appeals of Texas, Texarkana, affirmed.

Although Lee was a former remainder beneficiary under the Trust created by the Will, this was not sufficient to give him standing to contest probate of the Second Codicil. To have standing to contest probate of the Second Codicil Lee needed an interest under either the Second Codicil, which he was contesting, or the First Codicil, which he hoped would be operative. However, Lee held no express interest under the terms of either the First Codicil or the Second Codicil. Further, Lee held no interest under the Agreement, which was invalidated by the spendthrift terms prohibiting alienation of trust assets of the Trust as outlined in the Will and as republished by the First Codicil. Therefore, Lee did not have standing to contest the Second Codicil.

64. **Rachins v. Minassian, 2018 WL 3387236 (Florida 2018)**

The remainder beneficiaries of a family trust were qualified beneficiaries under Florida law with standing to challenge a trust's administration, even though they would receive their interests through newly created trusts

The settlor (the "Settlor") established a trust which, at his death in 2010, when the federal estate tax was not in effect, funded a family trust (the "Family Trust") with the Settlor's entire residuary estate. The Settlor's wife (the "Wife"), who was not the mother of the settlor's children (the "Children"), had absolute discretion to make distributions from the Family Trust during her lifetime to herself for health, education, and maintenance. Upon the death of the Wife the Family Trust would terminate and the trust would be divided into separate trusts for the benefit of each of the Children. Soon after the death of the Settlor, the Children challenged the Wife's administration of the Trust for a number of reasons, including the Wife's alleged gambling habit.

The wife successfully sought dismissal of the Children's suit, claiming the Children were neither beneficiaries nor Qualified Beneficiaries of the Family Trust. The Children appealed, claiming

they are Qualified Beneficiaries under the provisions of the Florida Trust Code and, therefore, had standing to question whether the wife is properly administering the trust corpus.

Section 736.0103(16) of the Florida Trust Code states that a Qualified Beneficiary "means a living beneficiary who, on the date the beneficiary's qualification is 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 without causing the trust to terminate; or

c. Would be a distributee or permissible distributee of trust income or principal if the trust terminated in accordance with its terms on that date.

Under Florida case law, Qualified Beneficiaries have standing to challenge the administration of a trust.

The District Court of Appeals of Florida, Fourth District, reversed holding that the Children were Qualified Beneficiaries of the Family Trust. The Children were Qualified Beneficiaries of the Family Trust with standing to challenge the administration of the Family Trust during the Wife's lifetime, even though the Family Trust would terminate at the death of the Wife, and even though the remaining principal of the Family Trust would flow to the Children via newly created trusts rather than via outright distributions from the terminated Family Trust.

The Children are beneficiaries because they have future beneficial interest in any property remaining in the Family Trust after the Wife's death, since any remaining property remaining in the Family Trust will be disbursed to a new trust for the Children's benefit under the terms of the original trust document. That means because any remaining property in the Family Trust would be distributed to a new trust created for the benefit of the Children upon the Wife's death, the Children will, at a minimum, have an equitable interest in any property in the Family Trust at that time.

The fact that any remaining principal of the Family Trust would flow into a new trust created for the Children, as opposed to being distributed to the Children outright, did not preclude the Children from being beneficiaries of the Family Trust under the statutory definition.

Similarly, the fact that the Family Trust terminated upon the Wife's death does not preclude the Children from having a beneficial interest in the Family Trust as, by definition, a remainder interest in a trust refers to the right to receive trust property upon the termination of the trust.

The Children are also Qualified Beneficiaries of the Family Trust because the term "qualified beneficiary" includes a living beneficiary who "[w]ould be a distributee or permissible distributee of trust income or principal if the trust terminated in accordance with its terms on that date. Here, the children are qualified beneficiaries under section 736.0103(16)(c), because they would be distributes of trust principal if the Family Trust terminated in accordance with its terms (i.e., the wife died).

The District Court of Appeals found the definition of "qualified beneficiary" under subsection (16)(c) includes the Children in this situation, even though the Family Trust terminates at the wife's death and even though the Children would be distributes of any remaining trust principal in the Family Trust only through a newly-created trust for their benefit.

The District Court of Appeals concluded that the Wife's unlimited power to invade the Family Trust was subject to implied limitations to protect beneficiaries with an interest in any property that might remain in the Family upon the Wife's death which gave the Children standing to challenge the Wife's administration of the Family Trust.

65. Trudel v. SunTrust Bank, 288 F. Supp. 3d 239 (D.D.C. 2018)

Bank did not owe fiduciary duties to a deceased savings account owner. Therefore, the court denied request from the customer's children for an equitable accounting

In 1994, Ukrainian businessman Yevgenyi Scherban opened a savings account at SunTrust Bank and funded it with $1 million. Although the bank records were unclear, it appeared that Scherban named his wife, Nadejda Nikitina, and his son, Ruslan, as the beneficiaries of the account. In 1996, Scherban and Nikitina were murdered. At the time of their deaths, over $1 million remained in the account.

In December 1996, after Scherban and Nikitina's deaths, an individual posing as Nikitina asked SunTrust to wire $282,000 to an entity in the Czech Republic. Although Nikitina was deceased, the bank approved the transfer.

In 2003, the account had a zero balance and SunTrust closed the account. Neither the bank nor Scherban's children could locate withdrawal records for the remaining $812,215. Although he was a beneficiary of the account, Ruslan stated that his father's personal assistant oversaw the family's American assets, and Ruslan never received account statements.

Scherban's children suggested that SunTrust had converted the money for itself. They produced a June 2002 letter purportedly from the bank to lawyers for Nikitina's estate, which stated that there had been no customer-initiated activity on the account since Scherban opened it. However, the children also produced a statement showing an unexplained debit of $50,000 in 1997.

SunTrust, meanwhile, claimed it had no record of the letter. The Bank blamed Scherban's personal assistant for the missing funds, but it could not produce definitive evidence to support its theory.

Scherban's children sued SunTrust for an equitable accounting. After discovery, both sides moved for summary judgment.

An accounting is a general investigation of the transactions between parties. A court will grant a request for an accounting only if (1) the transaction is complex or the parties shared a fiduciary relationship and (2) the remedy at law is inadequate. Banks generally do not have a fiduciary relationship with their depositors, but one can arise if there is an established relationship of trust and confidence. A bank can create such a fiduciary relationship if it takes on additional

responsibilities, receives greater compensation than from a typical transaction or exercises excessive control.

The District Court for the District of Columbia held that the children were not entitled to an accounting for the savings account. The Bank did not provide special services nor did the children rely on SunTrust to manage or control the assets. Therefore, the Bank did not owe fiduciary duties to Scherban or the children. The District Court accordingly dismissed the children's claim for an accounting.

66. **<u>EGW v. First Federal Savings Bank of Sheridan</u>, 413 P.3d 106 (2018)**

Wyoming strongly adheres to the notion that a testator has the absolute right to dispose of his property as he sees fit at his death assuming he is legally competent to do so, and therefore *in terrorem* clauses do not violate public policy even when an action challenging such a clause is brought in good faith or is based on probable cause

Allen Willey created the Allen F. Willey Trust in 2001 (the “2001 Trust”) as a revocable trust to manage his assets during his lifetime and dispose of them at his death. Mr. Willey served as trustee during his life and initially named his son, Spencer, as successor trustee. The beneficiaries of the 2001 Trust were Spencer’s minor children, E.W. and A.W.

Mr. Willey amended the trust several times between 2006 and 2010 to add his wife’s daughter and granddaughter as beneficiaries and to remove Spencer as a beneficiary. In 2014 another amendment to the 2001 Trust was made to remove Spencer from his role as successor trustee and to replace him with First Interstate Bank of Sheridan. Further, an *in terrorem*, or “no-contest clause”, was also added to the 2001 Trust. The no-contest clause specifically stated a challenge by Spencer, Mr. Willey’s grandchildren, his sisters or their children, or anyone purportedly acting on behalf of any of them shall terminate any interest they had in the 2001 Trust.

Mr. Willey entered into a listing agreement with a real estate broker in 2013 to sell the Willey Ranch, an asset of the 2001 Trust. In an attempt to prevent the sale of the ranch, Spencer filed a Complaint for Injunction and Declaratory Judgment against (1) Mr. Willey in his individual capacity and as the Trustee of the Allen F. Willey Trust, and (2) Mr. Willey’s wife, Bertha. The Complaint sought to set aside the listing agreement for the ranch and remove Mr. Willey from the role of Trustee on the basis of incapacity. Spencer also alleged Bertha exercised undue influence over Mr. Willey. Spencer further asserted an oral agreement existed between his father and himself that Spencer was to inherit the Willey Ranch and therefore sale of the ranch would constitute a breach of that agreement.

Mr. Willey passed away during the proceedings. The trial court allowed Spencer’s claims to proceed to trial where the jury found the trust amendments were not a product of undue influence; this verdict was appealed and affirmed by the Supreme Court of Wyoming.

In 2016, while his first action was pending, Spencer filed the current action on behalf of his two minor children, E.W. and A.W. (the “Minors”). The Minors’ action sought an injunction preventing the sale of the Willey Ranch, a declaratory judgment that the *in terrorem* clause did not apply to them, removal of First Federal as Trustee and damages for First Federal’s alleged breach of fiduciary duties.

First Federal Savings Bank of Sheridan, Wyoming, in its capacity as the Successor Trustee of the 2001 Trust, as amended, and Irma Bertha Willey, Susan Williams, Martin Martinez, Leslie Lube, and Brittany Phillips (the “Defendants”) opposed the requested relief and moved for summary judgment on the grounds that the *in terrorem* clause voided the beneficial interests of the minors as a result of Spencer’s prior lawsuit.

The Minors argued that due to Spencer's lack of standing, as determined by the trial court in the prior litigation, the *in terrorem* clause was not triggered. They also argued that the *in terrorem* clause should be declared void as a violation of public policy.

The trial court granted the Defendants' Motion for Summary Judgment. The trial court rejected the Minors' claims that Spencer had lacked standing to bring in the prior lawsuit. The trial court determined Spencer did have standing to challenge the 2010 Trust in the prior action and that challenge terminated the interests of E.W. and A.W. in the 2010 Trust. Further, the trial court determined *in terrorem* clauses do not violate Wyoming public policy.

Wyoming public policy favors an absolute right of an individual to dispose of their property as they see fit at their death. *In terrorem* clauses are enforceable regardless of the good faith or probable cause reasoning for instituting the action. The plain and unambiguous language of the document governs the interpretation of a trust agreement.

After de novo review, the Supreme Court of Wyoming affirmed the rulings of the trial court. The Supreme Court reviewed the findings of the 2014 action to confirm the trial court's decision that Spencer no longer had an interest in the 2010 Trust after the jury held there was no undue influence. There was not a decision stating Spencer lacked standing to assert that challenge.

The Wyoming Supreme Court reviewed, in depth, the public policy argument advanced by the appellants. The opinion pointed out that Wyoming courts, including the Wyoming Supreme Court, have well established precedent that states it is "the absolute right of the testator to dispose of his property after death as he sees fit, provided he is legally qualified so to do and acts as the law directs." The intent of the testator, as determined from the language of his will, controls the disposition of his property.

The Wyoming Supreme Court rejected the Minors' argument that using the action of a parent to deprive the minor child of a property right violates constitutional provisions protecting minors and providing for due process and access to courts. The Wyoming Supreme Court, relying on decisions from other jurisdictions, found that beneficiaries do not have a right to testamentary bequests and are only granted those bequests subject to the testator's conditions. Where the testator clearly states the conditions in his will, it is not up to the court to alter those conditions based on what it deems "fair".

The Wyoming Supreme Court also rejected the Minors' argument that Mr. Willey was alive at the time of the prior suit and therefore could have removed them as beneficiaries, but his failure to do so indicated he did not intend for them to be disinherited. The Wyoming Supreme Court distinguished all the cases the Minors cited to support this argument and therefore they were not persuasive to the court.

67. **<u>In the Matter of the Will of E. Warren Bradway</u>, 2018 WL 3097060 (N.J. Sup. Ct. App. Div., June 25, 2018)**

New Jersey court admits to probate a codicil written entirely in the purported testator's blood

From 1997 to 2004, E. Warren Bradway and Marc Coleman were in a long-term relationship. Bradway and Coleman also operated a bed and breakfast together in Philadelphia. In 2001, Bradway executed a will naming Coleman as the primary beneficiary and executor of his estate.

In 2004, Bradway and Coleman ended their relationship. Bradway also won a judgment against Coleman related to the winding up of the bed and breakfast. Later that year, Bradway began a relationship with Kirston Baylock and eventually moved into Baylock's New Jersey home.

In 2006, using his own blood as ink, Bradway drafted a codicil to his 2001 will. This codicil named Baylock as primary beneficiary and executor of his estate by directing that all references to Coleman in the 2001 will be replaced with Blaylock's name. The codicil also referenced the 2001 will and partially forgave the judgment against Coleman.

Bradway died in April 2016. The next month, Bradway's estate filed a petition to admit the 2001 will and the codicil to probate in the Chancery Division of the New Jersey Superior Court. Coleman filed an answer, claiming that the codicil was invalid.

At trial, DNA experts agreed that the blood used to write the codicil came from a full sibling of Bradway's brothers. Handwriting experts testified that the signature on the codicil matched Bradway's handwriting. However, Coleman's handwriting expert testified that the signature could have been inserted later using manual or digital "cut-and-paste" techniques.

After the expert witnesses testified, the estate moved for a directed verdict to admit the codicil to probate. Coleman opposed the motion and promised to call two witnesses who would testify that the codicil was unsigned at Bradway's death. Nonetheless, the trial court granted the estate's motion and admitted the codicil to probate. Coleman appealed.

New Jersey law recognizes traditional wills executed in accordance with testamentary formalities and holographic wills where the document is signed and the material portions are in the testator's handwriting. An unsigned document may also be admitted to probate if the proponent shows, by clear and convincing evidence, that the decedent intended the document to constitute his will, a codicil to his will, or a revocation or revival of his will or codicil.

The Appellate Division affirmed the trial court's decision to admit the codicil to probate. The appellate court first concluded, because all the handwriting experts agreed the body of the codicil was written in Bradway's handwriting, that there was clear and convincing evidence that Bradway wrote the codicil. The question then became whether there was clear and convincing evidence that Bradway intended the codicil to alter his 2001 will. On this point, the appellate court agreed that the trial court had correctly ruled there was

The appellate court ruled that the codicil's references to the 2001 will, Coleman, and the bed and breakfast debt all established that Bradway intended to amend his will. Although Bradway's use of his own blood was "eccentric", that too evidenced that Bradway intended the document to be a codicil. Therefore, the trial court did not err by admitting the codicil to probate.

68. **<u>Horgan v. Cosden</u>, 2018 WL 2374443 (Fla. Dist. Ct. App. May 25, 2018), review denied, No. SC18-1112, 2018 WL 3650268 (Fla. July 30, 2018)**

Early termination of a trust can only occur for the best interest of the beneficiaries when viewed in the light of the settlor's intentions

Yvonne S. Cosden created a revocable trust in 1993. This trust was amended and restated in 1998 and on January 24, 2004, as the Second Amendment to and Restatement of The Yvonne S. Cosden Revocable Trust Dated 7/29/93 (the "Trust"). Mrs. Cosden died in 2010, and the Trust became irrevocable. Joseph J. Horgan, Mrs. Cosden's personal assistant and friend, and Christopher E. Cosden, her only child, are the successor co-trustees. The Trust provides Mr. Cosden the net income for life, and upon his death, three higher educational institutions receive the principal. The Trust did not include a provision about early termination but did include a spendthrift provision.

In August 2015, Mr. Cosden and the remainder beneficiaries entered into an agreement to terminate the trust early and divide the $3 million in trust assets between them based on the actuarial value of their interests. Mr. Horgan, as co-trustee, did not agree with the early termination. In October 2015, Mr. Cosden filed a suit against Mr. Horgan, as co-trustee, seeking to terminate the Trust and a court order directing the distribution of assets in accordance with the beneficiaries' agreement. Mr. Horgan responded stating that the termination of the Trust was against the settlor's wishes to provide for her son for the rest of his life.

Both Mr. Cosden and Mr. Horgan moved for summary judgment in their favor. The Florida trial court granted summary judgment in favor of Mr. Cosden. The trial court directed termination of the Trust as provided in the agreement relying on Florida statutes that allow a court to terminate a trust if termination is not inconsistent with the settlor's purpose and is in the best interests of the beneficiaries. Mr. Horgan appealed.

Florida law allows termination of a trust when the modification or termination is not inconsistent with the settlor's purpose and the trust's purpose no longer exists, has been fulfilled, or has become illegal, impossible, wasteful, or impracticable to fulfill. A trust can also be terminated if such termination is in the best interest of the beneficiaries. However, it is not enough for the beneficiaries to all agree, rather, there must be evidence that the termination would not violate the settlor's intent.

On appeal, the Second District Court of Appeals reversed and remanded the case, directing the trial court to enter a final order of summary judgement denying the termination of the Trust.

The Second District Court of Appeals held that the plain language of the Trust determines the settlor's intent. The plain language showed Mrs. Cosden wanted to provide for her son financially via incremental distributions of income until he died and then give the remainder to the three educational institutions. The District Court found that early termination of the Trust would frustrate these purposes of the Trust. Here, the facts did not support a finding that Trust assets were being wasted, that the purposes of the Trust had been fulfilled or that an early termination was in the best interest of the beneficiaries when considered in view of the settlor's intent.

69. **In Estate of Burkhalter, 806 S.E.2d 875 (Ga. Ct. App. 2017)**

> **The probate court finding that the petitioners' proposed declaratory judgment actions would not violate a will's terrorem clause was wrongfully decided because (1) a question regarding the validity of an *in terrorem* clause must be raised and resolved in the first declaratory judgment action raising that issue, and (2) the request for a declaration that a future petition to remove the executors would not violate the *in terrorem* clause lacked sufficient specificity for the trial court to make the required analysis that such a request would not be a violation of the *in terrorem* clause.**

The will of Louise Ray Burkhalter contained an *in terrorem* clause that read, in part, "[a]ny person … who attacks in any court of law any provision of my [will], or the administration of my estate … shall be specifically disinherited from any portion of my estate that would go to them." Louise's sons, William and John, were the executors of Louise's estate, which was probated in the Bibb County Probate Court. Two of Louise's other children, Nancy and George, filed a petition for declaratory judgement requesting a ruling that they could, without triggering the *in terrorem* clause of the will, file additional declaratory judgment actions regarding (i) the substantive provisions of the will, (ii) the *in terrorem* clause of the will, and (iii) removal of William and John as executors.

The probate court denied the declaratory judgment regarding the substantive provisions of the will, but entered a declaratory judgment permitting Nancy and George to file subsequent petitions regarding the *in terrorem* clause and to remove the executors, without triggering the *in terrorem* clause. The executors appealed.

As interpreted by case law, the Georgia Declaratory Judgment Act permits an interested party to seek a declaration concerning the validity of an *in terrorem* clause without triggering the *in terrorem* clause. Additionally, Georgia courts previously held that a declaratory judgment can be used, without triggering the *in terrorem* clause, to determine whether the proposed actions would violate the *in terrorem* clause.

On appeal, the Court of Appeals of Georgia overruled the Probate Court's decision granting the petitioners' declaratory judgment request. The Court of Appeals found no authority to support "a procedure by which an interested party may file one declaratory judgment action to determine whether it may file a second declaratory judgment action to determine the validity of an *in*

terrorem clause. Rather, a question regarding the validity of an *in terrorem* clause should be resolved in the first declaratory judgment action raising that issue."

The Court of Appeals also found that the probate court improperly granted the declaratory judgment request regarding the validity of an action to remove the executors.

The Court of Appeals explained that, although an action to remove executors is not necessarily a violation of an *in terrorem* clause, the petitioners did not provide the probate court with sufficient detail regarding their proposed removal action for the probate court to properly determine whether such action would be a violation of the *in terrorem* clause. The petition did not attach a proposed complaint seeking the executors' removal or otherwise stating the basis for a suit to remove them. "Absent such allegations," the Court of Appeals held that the record was insufficient to support the conclusion of the probate court that the "… proposed Petition to remove the executors [would] not violate the *in terrorem* clause." Therefore, the Court of Appeals remanded the decision to the probate court to undertake the proper analysis.

OTHER ITEMS OF INTEREST

70. **Sveen v. Melin _____ U.S. _____ (2018)**

Supreme Court holds that retroactive application of Minnesota statute providing that the dissolution or annulment of a marriage revokes any revocable beneficiary designation made by an individual to the individual's former spouse does not violate the Contracts Clause of the Constitution

In 2002, Minnesota enacted Minn. Stat. § 524-2-804, subd. 1, that provided that the "dissolution or annulment of a marriage revokes any revocable . . . beneficiary designation . . . made by an individual to the individual's former spouse." Under this statute, if one spouse has made the other the beneficiary of a life insurance policy or similar asset, their divorce automatically revokes that designation so that the insurance proceeds will instead go to the contingent beneficiary or the policyholder's estate upon his or her death. The law did this on the theory that the policyholder would want that result. However, if the policyholder did not want this result the policyholder could rename the ex-spouse as beneficiary.

Mark Sveen and Kaye Melin were married in 1997. In 1998, Sveen purchased a life insurance policy naming Melin as the primary beneficiary and designating his two children from a prior marriage, Ashley and Antone Sveen, as contingent beneficiaries. Sveen and Melin divorced in 2007, but the divorce decree made no mention of the insurance policy and Sveen took no action to revise his beneficiary designations. Sveen passed away in 2011. Melin and the Sveen children made competing claims to the insurance proceeds.

The Sveens argued that under Minnesota's revocation and divorce law, their father's divorce cancelled Melin's beneficiary designations, leaving them as the rightful beneficiaries. Melin claimed that because the law did not exist when the policy was purchased and she was named as the primary beneficiary, the application of the later-enacted law to the insurance policy violated the Contracts Clause of the Constitution. The District Court ordered the payment of the

insurance money to the Sveens, while the Eighth Circuit Reversed, holding that the retroactive application of Minnesota's law violated the Contracts Clause.

The Supreme Court in an 8 to 1 decision with Justice Gorsuch dissenting, held that the retroactive application of the Minnesota statute did not violate the Contracts Clause. It noted that the Contracts Clause restricts the power of states to disrupt contractual arrangements but it does not prohibit all laws affecting preexisting contracts. There is a two-step test for determining when such a law crosses the Constitutional line. The test first asks whether the state law has "operated as a substantial impairment of a contractual relationship." In answering the first question, the court considers the following:

1. The extent to which the law undermines the contractual bargain;

2. The extent to which the law interferes with a party's reasonable expectations; and

3. The extent to which the law prevents the party from safeguarding or reinstating his or her rights.

If those factors show a substantial impairment, the inquiry then turns to the second test of whether the state law is drawn in an "appropriate" and "reasonable" way to "advance a significant and legitimate public purpose."

The court only looked at the first test. In its opinion, the three aspects of Minnesota's law, taken together, showed that the law did not substantially impair pre-existing contractual arrangements. First, the law is designed to reflect the policyholder's intent. Thus, it supports, rather than impairs, the contractual scheme. The law applied a prevalent legislative presumption that a divorcee would not want his or her former partner to benefit from his or her life insurance policy and other will substitutes. As a result, the law honors and does not undermine the intent of the only contracting party to care about who the beneficiaries are.

Second, the law is unlikely to disturb any policyholder's expectations at the time of contracting because an insured cannot reasonably rely on a beneficiary designation staying in place after a divorce. The court noted that divorce courts have wide discretion to divide property upon the dissolution of a marriage, including the revocation of spousal beneficiary designations and life insurance policies or mandating that such designations remain in place. A life insurance purchaser cannot know what will happen to that policy in the event of a divorce and, as a result, the purchaser's reliance interest is "next to nil." That fact cuts against providing protection under the Contracts Clause.

Finally, the law supplied a mere default rule, which the policyholder could undo at any moment. If the law's presumption about the desire of insured after divorcing is wrong, the insured could change it by sending a change of beneficiary form to the insurer. The court noted that it had long held that laws imposing such minimal paperwork burdens do not violate the Contracts Clause. Filing a change of beneficiary form is easy. And if an insured wanted his or her ex-spouse to stay as the beneficiary but did not send in the form, the result is only that the insurance is

redirected to the contingent beneficiaries, not that the insured's contractual rights are extinguished.

71. **Letter Ruling 201839005 (Issued June 25, 2018; Released September 28, 2018)**

Taxpayer allowed to rollover deceased husband's state maintained retirement plan into IRA

Decedent died in 2017 and was survived by his wife and his children. The decedent was employed by a state and was a participant in a qualified plan maintained by the state. Under the terms of the plan, upon a participant's death, the plan proceeds were payable to the participant's designated beneficiary. However, if a participant lacked a valid designated beneficiary in effect at the time of death, the participant's benefit was payable to the participant's estate. In this letter ruling, the decedent did not have a designated beneficiary in effect at the time of death and the entire plan benefit was payable to the decedent's estate.

Because the decedent died intestate, his estate would have been payable to his wife and the children under state law. However, the children validly disclaimed their interest in the decedent's estate. As the result, the wife was the sole beneficiary of the estate. The wife, as the surviving spouse of the decedent and sole beneficiary of the estate, desired to cause the plan to pay the decedent's benefit to the estate and within 60 days after the date of distribution from the plan to roll the entire distribution from the plan into a IRA set up and maintained in the name of the wife. The wife sought a ruling that the proposed rollover of the plan benefit into an IRA would have no adverse income tax consequences and the amount distributed would be excluded from the wife's income.

The Service ruled that the taxpayer could rollover the plan benefit into an IRA provided that the rollover was completed within 60 days and to the extent that the amount distributed from the plan was timely rolled over to that IRA it would be excluded from income under Section 402(c)(1). Section 402(c)(1) provides generally that if any portion of an eligible rollover distribution from a qualified trust is transferred into an eligible retirement plan, the portion of the distribution so transferred shall not be includable in gross income. An IRA is an eligible retirement plan for purposes of the rollover.

72. **United States v. Jan M. Mengedoht, ______, F. Supp. 3d ______ (Dist. Neb. 2019)**

Court allows foreclosure for unpaid estate taxes

This case was heard on a Motion for Summary Judgment brought by the government and was a civil action to reduce tax assessments to judgment and to enforce a federal tax lien.

The government sued Jan M. Mengedoht in his individual capacity and in his official capacities as executor of the Carl M. Mengedoht Estate and as trustee of the HCJ Holdings Trust and the Washington County Treasurer in order to enforce IRS tax liens against the estate. The Washington County Treasurer and Jan Mengedoht, individually, and as trustee of the trust, were sued only so that they could protect any interest that they might claim in the property.

Carl Mengedoht died on May 29, 1998. The estate failed to file a federal estate tax return with the IRS. On April 18, 2011 the government assessed federal estate tax, penalties, and interest against the estate. The amount due with interest and statutory additions through October 1, 2018 was over $2,700,000. The major asset of the estate, constituting more than 90 percent of the value of the estate, was real estate in Washington County, Nebraska was held in the trust. The court held that under the terms of the trust, Carl Mengedoht held the power to alter, amend, revoke or terminate the trust at the time of his death and consequently the property was part of the estate for estate tax purposes under Sections 2036 and 2037.

Neither the estate nor the trust properly appeared or answered in the suit and the court entered default judgment against them on December 12, 2017.

The remaining issue in the case was whether Jan Mengedoht had a personal interest in the real estate that was subject to the federal tax lien that attached to the real property. The court found that Jan Mengedoht had not rebutted the presumption of correctness given the assessments by the IRS. Default judgment had been entered against the trust and the estate and those entities could claim that they had an interest that would have priority to the tax liens. The government and Washington County had agreed that any real property taxes that were owed to Washington County were entitled to priority over the federal tax liens. The court found that the government's lien should be enforced in accordance with Section 7403 and the property sold. After the satisfaction of the federal tax lien, any residual proceeds would be paid to the trust. The court noted that Jan Mengedoht was deposed in the case and, when asked if he had a personal interest in the property, he refused to answer, stating "I don't want to waive my natural right to not be compelled to be a witness against myself." He refused to answer other questions on numerous subjects.

73. Berkenfeld v. Lenet, _______ F.Supp.3d ________ (D.Md. 2018)

Broker not liable for annuity beneficiaries taking lump sum distributions

This case was before the court on a motion for summary judgment by the defendants Claire Blumberg passed away in February 2014 at which time she owned annuities issued by Lincoln Financial and Commonwealth/Scudder. When Blumberg died, her daughters and grandson were the beneficiaries of the annuities and each elected a lump sum distribution from the annuities. Each also elected not to have federal income tax withheld from their lump sum distributions. If the daughters and grandson had elected different distribution options, they could have avoided in excess of $200,000 in overall income tax liabilities. They alleged that they elected lump sum distributions because Lenet, an advisor at Morgan Stanley, advised them that the lump sum distribution was the only distribution option. The daughters and grandson sued Morgan Stanley and Lenet in Maryland state court for negligence and breach of fiduciary duty. The defendants remanded the case to federal court. The federal court ruled in favor of the financial advisor and Lenet.

According to the court, no contract or agreement existed between the parties obligating Lenet or Morgan Stanley to give tax advice or an opinion concerning plaintiffs' available distribution options. The plaintiffs also stated that Lenet advised them to seek independent tax advice

concerning their distribution options. The plaintiffs did not seek advice despite having financial advisors and tax experts at their disposal.

Each plaintiff also signed a statement in electing a lump sum disbursement for each annuity which expressly notified them of all available distributions option. Plaintiffs additionally elected not to have federal income tax withheld from their lump sum distributions despite having been warned in writing, "if you opt out of our tax withholding, you are still liable for applicable taxes on your distribution….you may want to discuss your withholding election with a qualified tax advisor."

The court found that the requirements for summary judgment were met. The party seeking summary judgment must bear the initial burden of demonstrating the absence of a genuine dispute of material fact. In reviewing a motion for summary judgment, the court must take all facts and inferences in the light most favorable to the non-moving party.

The court first examined the claims of negligence against Lenet and Morgan Stanley to see whether the defendant owed a duty to the plaintiffs, whether the defendant breached that duty, whether a causal relationship existed between the breach and the harm plaintiffs suffered, and the amount of damages.

The court stated that Lenet owed a duty of care to the plaintiffs. In addition, sufficient evidence existed to establish Lenet's breach because plaintiffs testified that Lenet erroneously advised that the lump sum distributions were the only disbursement option. Also, Lenet's advice did not conform to the standard of care that was owed to the plaintiffs. It was clear that professional standards of care required Lenet to research plaintiffs' disbursement options and advise them accordingly. As a result, Lenet's erroneous advice was negligent.

The evidence, construed most favorably to plaintiffs, also established causation. Plaintiffs showed that, but for Lenet's advice, they would not have chosen the lump sum distribution option. It was also foreseeable that plaintiffs would rely on the advice of a trusted financial advisor, the result of which was greater tax liability than that associated with the other distribution options. In addition, plaintiffs established a *prima facie* case of negligence against Lenet directly and vicariously as to Morgan Stanley. However, summary judgment was nonetheless warranted because plaintiffs was contributorily negligent.

As the court put it, this case is one in which no room for a difference of opinion exists as to the contributory negligence of the plaintiffs. Two plaintiffs had years of prior experience with annuities similar to the Lincoln and Commonwealth Scudder annuities. It was also undisputed that plaintiffs failed to exercise ordinary care to make prudent investment choices after Blumberg passed away. Despite Lenet expressly telling plaintiffs to obtain independent tax advice before electing a lump sum distribution, plaintiffs never did so even those they had professional advisors. Finally, the election form which plaintiffs used to select a lump sum distribution clearly identified all other distribution alternatives and required that plaintiffs select one. The Lincoln forms also stated, "Instructions, important information, please read carefully and completely". Defendant's motion for summary judgment was also granted on the breach of

fiduciary duty count. While a breach of fiduciary duty may support a negligence or breach of contract claim it is not a stand-alone cause of action under Maryland law.

74. Letter Ruling 201805011 (Issued November 2, 2017; Released February 2, 2018)

IRS grants extension to waive family attribution rules

Taxpayer was a domestic individual who was treated as the owner of stock of a corporation held by a grantor trust. Members of Taxpayer's family also directly owned stock of the corporation or were treated as owning corporation stock held by separate trusts. On one date, all of Taxpayer's trust's corporation stock was redeemed for a combination of cash and promissory notes.

Taxpayer requested an extension of time to file the statement required by Treas. Reg. § 1.302-4(a) to waive the family attribution rules with respect to a redemption of the corporation's shares that is treated as a complete termination of a shareholder's interest in a corporation. Taxpayer intended to file the election, but for various reasons, the election was not filed. Under Section 318, an individual is considered to own stock owned directly or indirectly by or for his spouse, children, grandchildren, and parents (the "family attribution rules"). Section 302(c)(2) provides that Section 318 shall not apply in determining if the redemption is a complete termination of interest if:

A. Immediately after the distribution, the distributee had no interest in the corporation other than as a creditor;

B. The distributee does not acquire any such interest (other than stock acquired by bequest or inheritance) within ten years from the date of such distribution; and

C. The distributee at such time and in such manner and the distributee notifies the secretary.

This notice must be filed on or with the distributee's first return for the taxable year in which the distribution occurs. The IRS found that under Treas. Reg. § 301.9100-3, relief could be granted. The information established that Taxpayer reasonably relied on a qualified tax professional who failed to make or advise Taxpayer to make a valid election and that the request for relief was filed before the failure to make the election was discovered by the Internal Revue Service. Taxpayer showed that it acted reasonably and in good faith, and that granting relief would not prejudice the interest of the government. Thus the requirements of Treas. Reg. §§ 301.9100-1 and 301.9100-3 had been satisfied, and the extension of time was granted.

75. United States v. Paulson, 204 F. Supp. 3d 1102 (S.D. Cal. 2018)

Court denies defendant's motion to stay proceedings pending decision of state court

Allen Paulson established a living trust in 1986. In 1988, Allen Paulson entered into an ante-nuptial agreement with Madeleine Pickens. The ante-nuptial agreement defined their respective separate property and established certain gifts for Madeleine in the event of Allen's death. Allen subsequently amended and restated the living trust several times in early 2000 prior to his death on July 19, 2000.

The living trust gave Madeleine the power to elect between receiving property under the anti-nuptial agreement or under the living trust but not both. The living trust also created a marital trust for Madeleine's benefit. Under the terms of the living trust, the marital trust was to receive a residence and all personal property located at the residence in Rancho Santa Fe, California. The living trust also gave Madeleine the right to receive a second residence located in Del Mar, California as well as the tangible property in that residence. The marital trust also was to receive 25 percent of the residue of the living trust. The living trust named Madeleine, Michael Paulson (Allen's son), and Edward White as the co-trustees of the marital trust.

At the time of Allen's death, all of Allen's assets were held in the living trust except his shares in the Gold River Hotel and Casino Corporation. The living trust assets included approximately $24,764,500 in real estate; $113,761,706 in stocks and bonds; $23,664,644 in cash and receivables, and $31,243,494 in miscellaneous assets. Accordingly, the estate assets totaled approximately $193,434,344. Michael Paulson, served as the executor of Allen's estate. Michael Paulson also became the co-trustee of the living trust, with Edward White until White's resignation on October 8, 2001. Thereafter, Nicholas V. Diaco acted as co-trustee of the living trust with Michael Paulson.

In April 2001, the estate requested an extension of time to file the Form 706 until October 19, 2001 and an extension of time to pay taxes until October 19, 2002. Both requests for extension were granted. On October 23, 2001, the IRS received the estate's Form 706 which was signed by Michael Paulson as co-executor of the estate. In completing the tax return, the estate elected to use the alternate evaluation date of January 19, 2001. The estate reported a total gross estate of $187,726,626, a net taxable estate of $9,234,172 and an estate tax liability of $4,459,051. On November 22, 2001, the IRS assessed the reported tax of $4,459,051. The estate elected to pay part of its taxes and defer the other portion under Section 6166. Accordingly, the estate paid $706,296 as the amount not qualified for deferral, leaving a deferral balance of $3,752,755 to be paid under the Section 6166 installment election. While the estate's tax return was under review, personal disputes arose between Michael, Madeleine, and other beneficiaries. In 2003, the parties reached a settlement which was approved by the California Probate Court. Under the 2003 settlement, Madeleine forewent property under both the ante-nuptial agreement and the living trust, instead choosing to receive direct distributions from the living trust. Madeleine received the Rancho Santa Fe residence, the Del Mar residence, and the stock in the Del Mar Country Club. These distributions were made directly to Madeleine as trustee of her separate property trust. During 2004, Michael, as trustee of the living trust, distributed $5,921,888 of trust assets to various individuals.

On January 16, 2005, the IRS issued a notice of deficiency to Michael as executor of the estate which proposed a $37,801,245 deficiency in estate tax. This was argued before the tax court and the tax court determined that the estate had $6,669,477 in additional estate tax which the estate

elected to pay under Section 6166. During 2006, Michael distributed an additional $1,250,000 from the living trust. In March 2009, the probate court removed Michael Paulson as trustee for misconduct. At that point, two other children of Allen, Vikki Paulson and James Paulson were appointed as co-trustees. They reported that the living trust had assets worth $13,738,727. On May 7, 2010, in response to one or more missed installment payments, the IRS issued the estate a notice of final termination, stating that the extension of time for payment under Section 6166 no longer applied. On June 10, 2010, the probate court removed James Paulson as a co-trustee for breach of court orders. Accordingly, Vikki remained as the sole trustee of the living trust.

On August 5, 2010, the estate filed a petition in the tax court challenging the proposed termination of the Section 6166 installment payment election. On February 28, 2011, Crystal Christensen was appointed as co-trustee of the living trust. At this time, the living trust assets were worth approximately $8,802,034. In May 2011, the tax court entered a stipulated decision sustaining the IRS's decision to terminate the installment payment election. Between June 28, 2011 and July 7, 2011, the IRS reported notices of federal tax liens against the estate in the property records of San Diego and Los Angeles counties. On August 16, 2012, Vikki Paulson and Crystal Christensen, as successor trustees to the living trust, filed a petition for review of the estate's collection due process rights with the tax court. This was dismissed by the tax court on April 18, 2013 for lack of jurisdiction because Michael Paulson, who was the court-appointed executor at the time the petition was filed, did not sign the petition.

From approximately 2007 through 2013, several disputes arose between Michael, Vikki, Crystal Christensen, James, and other interested parties which were eventually settled on June 3, 2013. As a result of the 2013 settlement, Michael obtained the living trust's ownership interest in Supersonic Aerospace International LLC, the Gold River Hotel and Casino Corporation, and the Gold River Operation Corporation. As of July 10, 2015, the estate had an unpaid estate tax liability of $10,261,217. On September 16, 2015, the IRS filed a complaint seeking judgment against the estate for unpaid estate taxes and against, the defendants in either their representative or individual capacities or both for unpaid estate taxes.

As of September 16, 2015, there were several complaints against the trustees or executors for unpaid taxes and cross-claims between them. There were also several motions for summary judgment that were pending on the eve of decision in this matter.

Vikki and Crystal requested that the court stay the various motions for summary judgment while the California Probate Court heard their petition which was filed on February 13, 2018. The court noted that in determining when a stay is appropriate, it must weigh competing interest and maintain an even balance. In determining whether to grant the stay, courts considered three factors:

1. the possible damage which may result in granting the stay;
2. the hardship or inequity which a party may suffer in being required to go forward; and

3. the orderly course of justice measured in terms of the simplifying or complicating of issues, proof, and questions of law which could be expected result from a stay.

The court in looking at the request determined that the defendants would not suffer undue hardship if the action was not stayed. It then noted, that the government would be prejudiced if a stay were granted. It noted the defendants made this request nearly three years after the government first filed this action and provided no indication of when the probate court would resolve the issues. In addition, the probate petition would not simplify the issues before the court. Instead, because this case invoked the federal question, as well as issues that the federal court had been dealing with since 2015, staying the case would be "unconstructive". As a result, all three factors weighed against the defendants' motion to stay and the motion was denied.

76. **Comptroller of the Treasury v. Taylor, 189 A.3d 799 (Md. Ct. Spec. App. July 25, 2018), In re Estate of Seiden, NYLJ 10/12/18 p. 23, col. 5 (N.Y. County Surr. Ct.)**

Maryland and New York Courts address impact of federal QTIP elections on calculation of state death taxes

The facts in these cases are simple; however, the consequences could be complex. In 1981, when Congress added Section 2056(b)(7) to the Code to permit what have become known as QTIP trusts, it seemed like such a perfect idea. Even though the trust for the surviving spouse (or donee spouse under Section 2523(f)) did not need any of the traditional features that by their terms would include the value of the trust assets in the surviving spouse's gross estate – such as a general power of appointment in the case of Sections 2056(b)(5) and 2523(e) or payment to the estate in the case of Treas. Reg. §20.2056(c)-2(b)(1)(iii) – that inclusion in the surviving spouse's gross estate was assured by the contemporaneous enactment of Section 2044, providing for inclusion whenever a marital deduction was allowed under Section 2056(b)(7) or 2523(f), backstopped by Section 2519 in the case of the surviving spouse's actions during life. Thus was maintained the fundamental character of the marital deduction as a deferral only – the asset escapes tax at the first death but is taxed at the second death. Even if the surviving spouse who is a U.S. citizen moves out of the country, Section 2001(a) continues to apply, and if such a surviving spouse with sufficient income or assets also renounces that U.S. citizenship, Sections 877 and 2107 ensure continued taxation for 10 years. Meanwhile, the 1981 objective of making the marital deduction unlimited without having to give the surviving spouse control over the disposition of the remainder is fulfilled in the QTIP trust.

Since 2001 and the three-year phase-out of the credit for state death taxes, and especially with state legislatures setting their estate tax exemptions lower than the federal basic exclusion amount, some states that still have an estate tax have provided for a state-only QTIP election, available when the estate is under the federal exclusion amount but not under the state exemption, or applicable to the extent the state exemption is less than the federal exclusion amount. But symmetry is lost to the fact that a state is powerless when the surviving spouse moves out of the state. "Worldwide," or nationwide taxation is not allowed, and, under Section 1 of the Fourteenth Amendment to the U.S. Constitution, a citizen of a state loses that citizenship

merely by moving to another state. That dissymmetry is the backdrop for these cases identified as the sixth top development of 2018.

In Taylor, the predeceased spouse died domiciled in Michigan and created a trust. Both federal and Michigan QTIP elections were made. The surviving spouse moved to Maryland and died domiciled in Maryland.

The Maryland court held that Maryland cannot tax the QTIP trust because no Maryland QTIP election had been made. The court cited Code of Maryland-Tax-General §7-309(b)(6)(i) (emphasis added):

"For purposes of calculating Maryland estate tax, a decedent shall be deemed to have had a qualifying income interest for life under §2044(a) of the Internal Revenue Code with regard to any property for which a marital deduction qualified terminable interest property election was made for the decedent's predeceased spouse *on a timely filed Maryland estate tax return*."

In Seiden, the predeceased spouse died domiciled in New York in 2010, when there was no federal estate tax. But New York still had its estate tax, and a New York-only QTIP election was made. The surviving spouse did not move out of the state and died domiciled in New York.

The New York court held that New York cannot tax the QTIP trust because New York totally piggybacks on the federal gross estate, and there was no QTIP trust for federal estate tax purposes. Like the Maryland court in Taylor, the New York court relied on the New York statute, New York Tax Law §954(a), which provides that the New York gross estate of a deceased resident "means his or her federal gross estate." Because there was no federal QTIP election, the value of the trust assets was not included in the federal gross estate and hence were not included in the New York gross estate either.

The outcomes in these cases seem rather random and state-statute specific. For example, if the surviving spouse of the Michigan decedent in Taylor had moved to New York instead of Maryland, it appears that New York would tax the trust at the surviving spouse's death, because the federal QTIP election would ensure inclusion in the survivor's federal gross estate, which would then mean inclusion in the New York gross estate too.

The New York result in Seiden is not limited to surviving spouses of predeceased spouses who died in 2010. For example, if the first spouse died domiciled in New York in 2014 with a gross estate of $10 million, the federal exclusion would have been $5.34 million, and the New York exemption would have been $1 million. A reduce-to-zero marital bequest to a QTIP trust related solely to the federal estate tax would have been $4.66 million, leaving a tentative New York taxable estate of $3.66 million. New York tax could have been avoided with a New York-only QTIP election for a trust funded with $3.66 million. Upon the surviving spouse's death, in 2018 for example (assuming no changes in values), the federal gross estate would include the $4.66 million federal-QTIP trust, but not the $3.66 million New York-only-QTIP trust. A very odd result from the term "New York-only."

In addition, some states that have estate taxes may enact corrective legislation.

77. Changes in State Death Taxes in 2018 and 2019

Several states see changes in their state death taxes in 2018 and 2019

Numerous states either made changes or saw changes in their state death taxes as a result of the doubling of the federal estate tax applicable exclusion amount under the 2017 Tax Act.

On May 31, 2018, Connecticut changed its estate tax law to extend the phase-in of the exemption to 2023 to reflect the increase in the federal exemption to $10 million indexed for inflation in the 2017 Tax Act. The exemption will be phased in as follows:

2019: $3.6 million

2020: $5.1 million

2021: $7.1 million

2022: $9.1 million:

2023: federal exemption for deaths on or after January 1, 2023.

The District of Columbia decoupled its exemption from the federal exemption in 2018. DC Bill B22-0685 was introduced in the DC City Council on February 8, 2018 and was enacted on September 5, 2018. This law cut the DC threshold to $5.6 million indexed for inflation retroactive to January 1, 2018. The 2019 exemption was adjusted for inflation to $5,681,740.

In Hawaii, on June 7, 2018, the governor signed SB 2821, which amended HI ST § 236E-6 to reduce the Hawaiian exemption, effective January 1, 2018, to $5,000,000 indexed for inflation, which the Hawaii Department of Revenue read to be an exemption of $5,490,000 in 2018. Subsequently, for 2019, the Hawaii Department of Revenue has indicated that the Hawaii exemption will stay $5,490,000 for 2019.

Maine enacted a new law to set its exemption in 2018 at $5,600,000 indexed for inflation. Maine set its exemption at $5,700,000 for 2019.

In Maryland, on April 5, 2018, HB 0308 became law. The new law provided that for 2019 and thereafter, the Maryland threshold will be capped at the fixed amount of $5 million rather than being equal to the inflation-adjusted federal exemption as provided under prior law. The new law also provided for the portability of the unused predeceased spouse's Maryland exemption amount to the surviving spouse beginning in 2019.

New York, which was scheduled to see its exemption equal the federal exemption on January 1, 2019, will not because of the wording of its legislation. As of January 1, 2019, the New York

estate tax exemption amount will be the same as the federal estate tax applicable exclusion amount prior to the 2017 Tax Act which is $5,000,000 adjusted for inflation. The maximum rate of tax will continue to be 16%. New York set its exemption for 2019 at $5,740,000.

The State of Washington's 2019 exemption was not adjusted for inflation and is the same as the 2018 exemption of $2,193,000. On December 18, 2018, the Washington Department of Revenue sent an email stating that pursuant to Revised Code of Washington (RCW) 83.100, the Department must adjust the Washington applicable estate tax exclusion amount annually using the Seattle-Tacoma-Bremerton metropolitan area October consumer price index (Seattle CPI). As of January 1, 2018, the US Bureau of Labor and Statistics (USBLS) no longer calculated the consumer price index for the Seattle-Tacoma-Bremerton metropolitan area. Instead, the USBLS now calculates the Seattle-Tacoma-Bellevue Core Based Statistical Area for the Puget Sound region. As a result of these changes, the definition of "consumer price index" in RCW 83.100.020(1)(b) does not match with the current CPI measure calculated by the USBLS. The Department is using the last CPI figure for the Seattle CPI. This resulted in no increase in the applicable exclusion amount for 2019.

78. **2019 State Death Tax Chart (as of January 26, 2019)**

State **Type of Tax**	**Current Law**	**2019 State Death Tax Threshold**
Alabama None	Tax is tied to federal state death tax credit. AL ST § 40-15-2.	
Alaska None	Tax is tied to federal state death tax credit. AK ST § 43.31.011.	
Arizona None	Tax was tied to federal state death tax credit. AZ ST §§ 42-4051; 42-4001(2), (12). On May 8, 2006, Governor Napolitano signed SB 1170 which permanently repealed Arizona's state estate tax.	
Arkansas None	Tax is tied to federal state death tax credit. AR ST § 26-59-103; 26-59-106; 26-59-109, as amended March, 2003.	
California	Tax is tied to federal state death tax credit. CA REV & TAX §§ 13302;	

State Type of Tax	Current Law	2019 State Death Tax Threshold
None	13411.	
Colorado None	Tax is tied to federal state death tax credit. CO ST §§ 39-23.5-103; 39-23.5-102.	
Connecticut Separate Estate Tax	On October 31, 2017, the Connecticut Governor signed the 2018-2019 budget which increased the exemption for the Connecticut state estate and gift tax to $2,600,000 in 2018, to $3,600,000 in 2019, and to the federal estate and gift tax exemption in 2020. On May 31, 2018, Connecticut changed its estate tax law to extend the phase-in of the exemption to 2023 to reflect the increase in the federal exemption to $10 million indexed for inflation in the 2017 Tax Act. The exemption will be phased in as follows: 2019: $3.6 million 2020: $5.1 million 2021: $7.1 million 2022: $9.1 million: 2023: federal exemption for deaths on or after January 1, 2023. Beginning in 2019, the cap on the Connecticut state estate and gift tax is reduced from $20 million to $15 million (which represents the tax due on a Connecticut estate of approximately $129 million).	$3,600,000

State Type of Tax	Current Law	2019 State Death Tax Threshold
Delaware None	On July 2, 2017, the Governor signed HB 16 which sunsets the Delaware Estate Tax on December 31, 2017.	
District of Columbia Pick-up Only	No separate QTIP election. DC Bill B22-0685 was introduced in the DC City Council on February 8, 2018. This proposal cut the DC threshold to $5.6 million adjusted for inflation retroactive to January 1, 2018. This change was enacted by the DC City Council on September 5, 2018 as part of the Budget Support Act.	$5,681,760
Florida None	Tax is tied to federal state death tax credit. FL ST § 198.02; FL CONST. Art. VII, Sec. 5	
Georgia None	Effective July 1, 2014, the Georgia estate tax was repealed. See § 48-12-1.	
Hawaii Modified Pick-up Tax	On May 2, 2012, the Hawaii legislature passed HB 2328 which conforms the Hawaii estate tax exemption to the federal estate tax exemption for decedents dying after January 25, 2012. On June 7, 2018, the governor signed SB 2821, which amended HI ST § 236E-6 to reduce the Hawaiian exemption, effective January 1, 2018, to $5,000,000 indexed for inflation. The Hawaii Department of Taxation released Announcement 2018-13 on	$5,490,000

State Type of Tax	Current Law	2019 State Death Tax Threshold
	September 4, 2018 in which it announced that the exemption will remain at the amount available to decedents dying during 2017. In response to calls from practitioners, the Hawaii Department of Taxation indicated that was not going to adjust the exemption for inflation in 2019.	
Idaho None	Tax is tied to federal state death tax credit. ID ST §§ 14-403; 14-402; 63-3004 (as amended Mar. 2002).	
Illinois Modified Pick-up Only	On January 13, 2011, Governor Quinn signed Public Act 096-1496 which increased Illinois' individual and corporate income tax rates. Included in the Act was the reinstatement of Illinois' estate tax as of January 1, 2011 with a $2 million exemption. Senate Bill 397 passed both the Illinois House and Senate as part of the tax package for Sears and CME on December 13, 2011. It increased the exemption to $3.5 million for 2012 and $4 million for 2013 and beyond. Governor Quinn signed the legislation on December 16, 2011. Illinois permits a separate state QTIP election, effective September 8, 2009. 35 ILCS 405/2(b-1).	$4,000,000
Indiana None	Pick-up tax is tied to federal state death tax credit. IN ST §§ 6-4.1-11-2; 6-4.1-1-4. On May 11, 2013, Governor Pence signed HB 1001 which repealed	.

State Type of Tax	Current Law	2019 State Death Tax Threshold
	Indiana's inheritance tax retroactively to January 1, 2013. This replaced Indiana's prior law enacted in 2012 which phased out Indiana's inheritance tax over nine years beginning in 2013 and ending on December 31, 2021 and increased the inheritance tax exemption amounts retroactive to January 1, 2012	
Iowa Inheritance Tax	Pick-up tax is tied to federal state death tax credit. IA ST § 451.2; 451.13. Effective July 1, 2010, Iowa specifically reenacted its pick-up estate tax for decedents dying after December 31, 2010. Iowa Senate File 2380, reenacting IA ST § 451.2. Iowa has a separate inheritance tax on transfers to others than lineal ascendants and descendants.	
Kansas None	For decedents dying on or after January 1, 2007 and through December 31, 2009, Kansas had enacted a separate stand alone estate tax. KS ST § 79-15, 203	
Kentucky Inheritance Tax	Pick-up tax is tied to federal state death tax credit. KY ST § 140.130. Kentucky has not decoupled but has a separate inheritance tax and recognizes by administrative pronouncement a separate state QTIP election.	
Louisiana None	Pick-up tax is tied to federal state death tax credit. LA R.S. §§ 47:2431; 47:2432; 47:2434.	
Maine	For decedents dying after December 31, 2002, pick-up tax was frozen at pre-	$5,700,000

State Type of Tax	Current Law	2019 State Death Tax Threshold
Pick-up Only	EGTRRA federal state death tax credit, and imposed on estates exceeding applicable exclusion amount in effect on December 31, 2000 (including scheduled increases under pre-EGTRRA law) (L.D. 1319; March 27, 2003). On June 20, 2011, Maine's governor signed Public Law Chapter 380 into law, which increased the Maine estate tax exemption to $2 million in 2013 and beyond. The rates were also changed, effective January 1, 2013, to 0% for Maine estates up to $2 million, 8% for Maine estates between $2 million and $5 million, 10 % between $ 5 million and $8 million and 12% for the excess over $8 million. On June 30, 2015, the Maine legislature overrode the Governor's veto of LD 1019, the budget bill for fiscal years 2016 and 2017. As part of the law, the Maine Exemption was tagged to the federal exemption for decedents dying on or after January 1, 2016. The tax rates are: 8% on the first $3 million above the Maine Exemption; 10% on the next $3 million above the Maine Exemption; and !2% on all amounts above $6 million above the Maine Exemption. The new legislation did not include portability as part of the Maine Estate	

State Type of Tax	Current Law	2019 State Death Tax Threshold
	Tax. On September 12, 2018, LP1655 became law without the Governor's signature. The new law amends M.R.S. Title 36, Section 4102 and Section 4119 to make the Maine exemption $5,600,000 adjusted for inflation for decedents dying on and after January 1, 2018. For estates of decedents dying after December 31, 2002, Sec. 2058 deduction is ignored in computing Maine tax and a separate state QTIP election is permitted. M.R.S. Title 36, Sec. 4062. Maine also subjects real or tangible property located in Maine that is transferred to a trust, limited liability company or other pass-through entity to tax in a non-resident's estate. M.R.S. Title 36, Sec. 4064.	
Maryland Pick-up Tax Inheritance Tax	On May 15, 2014, Governor O'Malley signed HB 739 which repealed and reenacted MD TAX GENERAL §§ 7-305, 7-309(a), and 7-309(b) to do the following: 1. Increased the threshold for the Maryland estate tax to $1.5 million in 2015, $2 million in 2016, $3 million in 2017, and $4 million in 2018. For 2019 and beyond, the Maryland threshold will equal the federal applicable exclusion amount.	$5,000,000

State Type of Tax	Current Law	2019 State Death Tax Threshold
	2. Continued to limit the amount of the federal credit used to calculate the Maryland estate tax to 16% of the amount by which the decedent's taxable estate exceeds the Maryland threshold unless the Section 2011 federal state death tax credit is then in effect. 3. Continued to ignore the federal deduction for state death taxes under Sec. 2058 in computing Maryland estate tax, thus eliminating a circular computation. 4. Permitted a state QTIP election. On April 5, 2018, HB 0308 became law. The new law provides that for 2019 and thereafter, the Maryland threshold will be capped at the fixed amount of $5 million rather than being equal to the inflation-adjusted federal exemption as provided under prior law. The new law also provides for the portability of the unused predeceased spouse's Maryland exemption amount to the surviving spouse beginning in 2019.	
Massachusetts Pick-up Only	For decedents dying in 2002, pick-up tax is tied to federal state death tax credit. MA ST 65C §§ 2A. For decedents dying on or after January 1, 2003, pick-up tax is frozen at federal state death tax credit in effect on	$1,000,000

State Type of Tax	Current Law	2019 State Death Tax Threshold
	December 31, 2000. MA ST 65C §§ 2A(a), as amended July 2002. Tax imposed on estates exceeding applicable exclusion amount in effect on December 31, 2000 (including scheduled increases under pre-EGTRRA law), even if that amount is below EGTRRA applicable exclusion amount. See, Taxpayer Advisory Bulletin (Dec. 2002), DOR Directive 03-02, Mass. Guide to Estate Taxes (2003) and TIR 02-18 published by Mass. Dept. of Rev. Massachusetts Department of Revenue has issued directive, pursuant to which separate Massachusetts QTIP election can be made when applying state's new estate tax based upon pre-EGTRRA federal state death tax credit.	
Michigan None	Tax is tied to federal state death tax credit. MI ST §§ 205.232; 205.256	
Minnesota Pick-up Only	Tax frozen at federal state death tax credit in effect on December 31, 2000, clarifying statute passed May 2002. Tax imposed on estates exceeding federal applicable exclusion amount in effect on December 31, 2000 (including scheduled increases under pre-EGTRRA law), even if that amount is below EGTRRA applicable exclusion amount. MN ST §§ 291.005; 291.03; instructions for MN Estate Tax Return; MN Revenue Notice 02-16. Separate state QTIP election permitted.	$2,700,000

State Type of Tax	Current Law	2019 State Death Tax Threshold
	On May 30, 2017, the governor signed the budget bill, H.F. No. 1 which increased the Minnesota estate tax exemption for 2017 from $1,800,000 to $2,100,000 retroactively, and increases the exemption to $2,400,000 in 2018, $2,700,000 in 2019, and $3,000,000 for 2020 and thereafter. A provision enacted in 2013 to impose an estate tax on non-residents who own an interest in a pass-through entity which in turn owned real or personal property in Minnesota was amended in 2014 to exclude certain publicly traded entities. It still applies to entities taxed as partnerships or S Corporations that own closely held businesses, farms, and cabins.	
Mississippi None	Tax is tied to federal state death tax credit. MS ST § 27-9-5.	
Missouri None	Tax is tied to federal state death tax credit. MO ST §§ 145.011; 145.091.	
Montana None	Tax is tied to federal state death tax credit. MT ST § 72-16-904; 72-16-905.	

State Type of Tax	Current Law	2019 State Death Tax Threshold
Nebraska County Inheritance Tax	Nebraska through 2006 imposed a pick-up tax at the state level. Counties impose and collect a separate inheritance tax. NEB REV ST § 77-2101.01(1).	
Nevada None	Tax is tied to federal state death tax credit. NV ST Title 32 §§ 375A.025; 375A.100.	
New Hampshire None	Tax is tied to federal state death tax credit. NH ST §§ 87:1; 87:7.	
New Jersey Inheritance Tax	On October 14, Governor Christie signed Assembly Bill A-12 which was the tax bill accompanying Assembly Bill A-10 which revised the funding for the state's Transportation Fund. Under this law, the Pick-Up Tax had a $2 million exemption in 2017 and was eliminated as of January 1, 2018. The new law also eliminated the tax on New Jersey real and tangible property of a non-resident decedent. The repeal of the pick-up tax did not apply to the separate New Jersey inheritance tax.	.
New Mexico None	Tax is tied to federal state death tax credit. NM ST §§ 7-7-2; 7-7-3.	
New York Pick-up Only	The Executive Budget of 2014-2015 which was signed by Governor Cuomo on March 31, 2014 made substantial changes to New York's estate tax.	$5,740,000

State Type of Tax	Current Law	2019 State Death Tax Threshold
	The New York estate tax exemption which was $1,000,000 through March 31, 2014 was increased as follows: April 1, 2014 to March 31, 2015 -- $2,062,500 April 1, 2015 to March 31, 2016 -- $3,125,000 April 1, 2016 to March 31, 2017 -- $4,187,500 April 1, 2017 to December 31, 2018 -- $5,250,000 As of January 1, 2019, the New York estate tax exemption amount will be the same as the federal estate tax applicable exclusion amount **prior** to the 2017 Tax Act which is $5,000,000 adjusted for inflation. The maximum rate of tax will continue to be 16%. Taxable gifts within three years of death between April 1, 2014 and December 31, 2018 will be added back to a decedent's estate for purposes of calculating the New York tax. The New York estate tax is a cliff tax. If the value of the estate is more than 105% of the then current exemption, the exemption will not be available. On April 1, 2015, as part of 2015-2016 Executive Budget, New York enacted	

State Type of Tax	Current Law	2019 State Death Tax Threshold
	changes to the New York Estate Tax. New York first clarified that the new rate schedule enacted in 2014 applies to all decedents dying after April 1, 2014. Previously, the rate schedule only applied through March 31, 2015. New York then modified the three year gift add-back provision to make it clear that the gift add-back does not apply to any individuals dying on or after January 1, 2019. Previously, the gift add-back provision did not apply to gifts made on or after January 1, 2019. New York continues not to permit portability for New York estates and no separate state QTIP election is allowed when portability is elected on a federal return.	
North Carolina None	On July 23, 2013, the Governor signed HB 998 which repealed the North Carolina estate tax retroactively to January 1, 2013.	
North Dakota None	Tax is tied to federal state death tax credit. ND ST § 57-37.1-04	
Ohio None	Governor Taft signed the budget bill, 2005 HB 66, repealing the Ohio estate (sponge) tax prospectively and granting credit for it retroactively. This was effective June 30, 2005 and killed the sponge tax. On June 30, 2011, Governor Kasich signed HB 153, the biannual budget bill, which contained a repeal of the Ohio state estate tax effective January 1,	

State Type of Tax	Current Law	2019 State Death Tax Threshold
	2013.	
Oklahoma None	Tax is tied to federal state death tax credit. OK ST Title 68 § 804 The separate estate tax was phased out as of January 1, 2010.	
Oregon Separate Estate Tax	On June 28, 2011, Oregon's governor signed HB 2541 which replaced Oregon's pick-up tax with a stand-alone estate tax effective January 1, 2012. The new tax has a $1 million threshold with rates increasing from ten percent to sixteen percent between $1 million and $9.5 million. Determination of the estate for Oregon estate tax purposes is based upon the federal taxable estate with adjustments.	$1,000,000
Pennsylvania Inheritance Tax	Tax is tied to the federal state death tax credit to the extent that the available federal state death tax credit exceeds the state inheritance tax. PA ST T. 72 P.S. § 9117 amended December 23, 2003. Pennsylvania had decoupled its pick-up tax in 2002, but has now recoupled retroactively. The recoupling does not affect the Pennsylvania inheritance tax which is independent of the federal state death tax credit. Pennsylvania recognizes a state QTIP election.	
Rhode Island Pick-up Only	Tax frozen at federal state death tax credit in effect on January 1, 2001, with certain adjustments (see below). RI ST § 44-22-1.1.	$1,561,719

State Type of Tax	Current Law	2019 State Death Tax Threshold
	Rhode Island recognized a separate state QTIP election in the State's Tax Division Ruling Request No. 2003-03. Rhode Island's Governor signed into law HB 5983 on June 30, 2009, effective for deaths occurring on or after January 1, 2010, an increase in the amount exempt from Rhode Island estate tax from $675,000, to $850,000, with annual adjustments beginning for deaths occurring on or after January 1, 2011 based on "the percentage of increase in the Consumer Price Index for all Urban Consumers (CPI-U). . . rounded up to the nearest five dollar ($5.00) increment." RI ST § 44-22-1.1. On June 19, 2014, the Rhode Island Governor approved changes to the Rhode Island Estate Tax by increasing the exemption to $1,500,000 indexed for inflation in 2015 and eliminating the cliff tax.	
South Carolina None	Tax is tied to federal state death tax credit. SC ST §§ 12-16-510; 12-16-20 and 12-6-40, amended in 2002.	
South Dakota None	Tax is tied to federal state death tax credit. SD ST §§ 10-40A-3; 10-40A-1 (as amended Feb. 2002).	
Tennessee None	Pick-up tax is tied to federal state death tax credit. TN ST §§ 67-8-202; 67-8-203. Tennessee had a separate inheritance tax	

State Type of Tax	Current Law	2019 State Death Tax Threshold
	which was phased out as of January 1, 2016.	
Texas None	Tax was permanently repealed effective as of September 15, 2015 when Chapter 211 of the Texas Tax Code was repealed. Prior to September 15, 2015, the tax was tied to the federal state death tax credit.	
Utah None	Tax is tied to federal state death tax credit. UT ST § 59-11-102; 59-11-103.	
Vermont Modified Pick-up	In 2010, Vermont increased the estate tax exemption threshold from $2,000,000 to $2,750,000 for decedents dying January 1, 2011. As of January 1, 2012 the exclusion is scheduled to equal the federal estate tax applicable exclusion, so long as the FET exclusion is not less than $2,000,000 and not more than $3,500,000. VT ST T. 32 § 7442a. Previously the estate tax was frozen at federal state death tax credit in effect on January 1, 2001. VT ST T. 32 §§ 7402(8), 7442a, 7475, amended on June 21, 2002. No separate state QTIP election permitted.	$2,750,000
Virginia None	Tax is tied to federal state death tax credit. VA ST §§ 58.1-901; 58.1-902. The Virginia tax was repealed effective July 1, 2007. Previously, the tax was frozen at federal state death tax credit in effect on January 1, 1978. Tax was	

State Type of Tax	Current Law	2019 State Death Tax Threshold
	imposed only on estates exceeding EGTRRA federal applicable exclusion amount. VA ST §§ 58.1-901; 58.1-902.	
Washington Separate Estate Tax	LEGISLATIVE FRAMEWORK. On February 3, 2005, the Washington State Supreme Court unanimously held that Washington's state death tax was unconstitutional. The tax was tied to the current federal state death tax credit, thus reducing the tax for the years 2002 - 2004 and eliminating it for the years 2005 - 2010. Hemphill v. State Department of Revenue 2005 WL 240940 (Wash. 2005). In response to Hemphill, the Washington State Senate on April 19 and the Washington House on April 22, 2005, by narrow majorities, passed a stand-alone state estate tax with rates ranging from 10% to 19%, a $1.5 million exemption in 2005 and $2 million thereafter, and a deduction for farms for which a Sec. 2032A election could have been taken (regardless of whether the election is made). The Governor signed the legislation. WA ST §§ 83.100.040; 83.100.020. Washington voters defeated a referendum to repeal the Washington estate tax in the November 2006 elections. On June 14, 2013, Governor Inslee signed HB 2075 which closed an exemption for marital trusts retroactively immediately prior to when the Department of Revenue was about to start issuing refund checks, created a	$2,193,000

State Type of Tax	Current Law	2019 State Death Tax Threshold
	deduction for up to $2.5 million for certain family owned businesses and indexes the $2 million Washington state death tax threshold for inflation. SEPARATE QTIP ELECTION. Washington permits a separate state QTIP election. WA ST §83.100.047. NO INDEXING FOR INLFATION IN 2019. Washington State was supposed to index the exemption annually for inflation. However, this was not done for 2019. On December 18, 2018, the Department of Revenue sent an email stating that pursuant to Revised Code of Washington (RCW) 83.100, the Department must adjust the Washington applicable estate tax exclusion amount annually using the Seattle-Tacoma-Bremerton metropolitan area October consumer price index (Seattle CPI). As of January 1, 2018, the US Bureau of Labor and Statistics (USBLS) no longer calculates the consumer price index for the Seattle-Tacoma-Bremerton metropolitan area. Instead, the USBLS will calculate the Seattle-Tacoma-Bellevue Core Based Statistical Area for the Puget Sound region. As a result of these changes, the definition of "consumer price index" in RCW 83.100.020(1)(b) does not match with the current CPI measure calculated by the USBLS. The Department is	

State Type of Tax	Current Law	2019 State Death Tax Threshold
	using the last CPI figure for the Seattle CPI. This resulted in no increase in the applicable exclusion amount for 2019.	
West Virginia None	Tax is tied to federal state death tax credit. WV § 11-11-3.	
Wisconsin None	Tax is tied to federal state death tax credit. WI ST § 72.01(11m). For deaths occurring after September 30, 2002, and before January 1, 2008, tax was frozen at federal state death tax credit in effect on December 31, 2000 and was imposed on estates exceeding federal applicable exclusion amount in effect on December 31, 2000 ($675,000), not including scheduled increases under pre-EGTRRA law, even though that amount is below the lowest EGTRRA applicable exclusion amount. Thereafter, tax imposed only on estates exceeding EGTRRA federal applicable exclusion amount. WI ST §§ 72.01; 72.02, amended in 2001; WI Dept. of Revenue website. On April 15, 2004, the Wisconsin governor signed 2003 Wis. Act 258, which provided that Wisconsin will not impose an estate tax with respect to the intangible personal property of a non-resident decedent that has a taxable situs in Wisconsin even if the non-resident's state of domicile does not impose a death tax. Previously, Wisconsin would	

State Type of Tax	Current Law	2019 State Death Tax Threshold
	impose an estate tax with respect to the intangible personal property of a non-resident decedent that had a taxable situs in Wisconsin if the state of domicile of the non-resident had no state death tax.	
Wyoming None	Tax is tied to federal state death tax credit. WY ST §§ 39-19-103; 39-19-104.	

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