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NOTABLE DEVELOPMENTS OF INTEREST TO ESTATE PLANNERS

PART 1 – TAX REFORM PROVIDES SIGNIFICANT CHANGES FOR ESTATE PLANNERS

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

A. Effective Date and Sunset

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

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

For estate and gift tax purposes, the 2017 Tax Act increased the basic exclusion amount under section 2010(c)(3) to $10 million as adjusted for inflation with a 2010 base year (the same base year as under prior law). Thus, the basic exclusion amount for 2019 for gift and estate tax purposes, and the generation-skipping transfer (“GST”) exemption amount under section 2631(c), is $11.14 million. Under the current applicable exclusion amount, the number of decedent’s estates subject to federal estate tax may only reach a few thousand, and taxpayers have the ability to make larger gifts during their lives free of gift tax. Just as important, taxpayers with less than the exclusion amount may transfer assets among themselves in order to include assets in the estate of a taxpayer most likely to die soonest. This creates enormous basis planning opportunities.

On November 23, 2018, proposed clawback regulations were issued. REG-106706-18. In a nutshell, the proposed regulations take the positions that (1) donors who paid gift tax on gifts prior to 2017 in excess of the original basic exclusion amount can make up to $5 million of gifts in 2018-2025 which will be protected from tax by the additional basic exclusion amount and (2) donors who die after 2025 and who made gifts in 2018-2025 that were protected from gift tax by the additional basic exclusion amount will be able to preserve the additional basic exclusion amount used against those gifts when their estate taxes are determined. So there is no “clawback” but in order to preserve the additional basic exclusion amount, a gift will have to be made. In other words, a donor who makes only a $5 million gifts before 2025 and dies after 2025 will not benefit from the additional exclusion.
The transfer tax rates were not changed by the 2017 Tax Act. The proposed regulations dealing with clawback do not mention GST. The Blue Book stated that during 2018-2025 additional GST exemption was available. Presumably Treasury does not believe that exemption disappears once allocated.

C. **Inflation Adjustments**

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

D. **Income Taxation of Individuals, Trusts and Estates**

1. **Standard Deduction.** The 2017 Tax Act (plus inflation) increased the standard deduction to $24,400 for taxpayers filing jointly or for a surviving spouse, $18,350 for head of household and $12,200 for single filers. Taxpayers who are blind or 65 years of age or older are eligible for an increased standard deduction as under prior law. Section 63(c)(2), (f). For 2019, the additional amount is $1,300, except that the additional amount is $1,650 for individuals who are also unmarried and not a surviving spouse. The amount of the standard deduction will be indexed for inflation using the C-CPI-U in tax years beginning after 2018. The effect of the standard deduction is that taxpayers receive it for “doing nothing”. Thus, to the extent possible, a taxpayer will want to bunch deductions to take zero in some years and lots in other years.

2. **Personal Exemption.** The personal exemption has been suspended. Section 151(d); 2017 Tax Act § 11041. The suspension of the personal exemption does not affect the exemption for trusts and estates, except that a qualified disability trust, which under prior law was entitled to the personal exemption of an individual. The 2017 Tax Act allows a deduction for a qualified disability trust of $4,200 during the years that the personal exemption is suspended. This deduction for qualified disability trusts is indexed for inflation. Section 642(b)(2)(C)(iii).

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

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

The new limitation, and the resulting efforts by states and taxpayers to devise alternate means for deducting the disallowed portion of their state and local taxes, has generated increased interest in the question of whether a state or local tax credit should be treated as a return benefit – a quid pro quo – when received in return for making a payment or transfer to an entity described in section 170(c). The Treasury Department and the IRS did not publish formal guidance on this question before the enactment of the limitation under section 164(b)(6). In 2010, however, the IRS Chief Counsel advised that, under certain circumstances, a taxpayer may take a deduction under section 170 for the full amount of a contribution made in exchange for a state tax credit, without subtracting the value of the credit received in return. See CCA 2010105010 (Oct. 27, 2010) (“the 2010 CCA”). IRS Chief Counsel has also taken the position in Tax Court litigation that the amount of a state or local tax credit that reduces a tax liability is not an accession to wealth includible in income under section 61 or an amount realized for purposes of section 1001. In these cases, the Tax Court agreed with the Chief Counsel’s position. See, for example, Maines v. Commissioner, 144 T.C. 123, 134 (2015); Tempel v. Commissioner, 136 T.C. 341, 351-54 (2011); aff’d sub nom. Esgar Corp. v. Commissioner, 744 F.3d 648 (10th Cir. 2014).

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

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

The Treasury Department and the IRS received over 7,700 comments responding to the proposed regulations and 25 requests to speak at the public hearing, which was held on November 5, 2018. Copies of written comments received and the list of speakers at the public hearing are available for public inspection at www.regulations.gov or upon request. The comments and revisions are discussed generally in this preamble. After considering the comments received and the concerns expressed at the public hearing, the Treasury Department and the IRS adopt the proposed regulations with certain revisions explained subsequently.
Section 67(e). Note that this does not include expenses of an estate or trust not subject to the 2% floor under Section 67(e). Expenses of an estate or trust are not subject to the 2% floor if such expenses would not have been incurred if the property were not held in a trust or estate. Thus, executor and trustee fees and attorney's fees related to trust and estate administration should continue to be deductible.

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

In Notice 2018-61 the IRS and Treasury adopted a generally favorable interpretation of section 67(g). The Notice states:

Commentators have suggested that new section 67(g) might be read to eliminate the ability of estates and non-grantor trusts to deduct any expenses described in section 67(e)(1) and §1.67-4 for the taxable years during which the application of section 67(a) is suspended. **The Treasury Department and the IRS do not believe that this is a correct reading of section 67(g).** For the taxable years during which it is effective, section 67(g) denies a deduction for miscellaneous itemized deductions. Section 67(b) defines miscellaneous itemized deductions as itemized deductions other than those listed therein. Section 63(d) defines itemized deductions by excluding personal exemptions, section 199A deductions, and deductions used to arrive at adjusted gross income. Therefore, neither the above-the-line deductions used to arrive at adjusted gross income nor the expenses listed in section 67(b)(1) – (12) are miscellaneous itemized deductions. Section 62(a) defines adjusted gross income of an individual, and section 67(e) provides that the adjusted gross income of a trust or estate is determined in the same way as for an individual, except that expenses described in section 67(e)(1) and deductions pursuant to sections 642(b), 651, and 661 are allowable as deductions in arriving at adjusted gross income. Thus, section 67(e) removes the expenses described in section 67(e)(1) from the category of itemized deductions (and thus necessarily also from the subset of miscellaneous itemized deductions) and instead treats them as above-the-line deductions allowable in determining adjusted gross income under section 62(a). **Therefore, the suspension of the deductibility of miscellaneous itemized deductions under section 67(a) does not affect the deductibility of payments described in section 67(e)(1).** However, an expense that commonly or customarily would be incurred by an individual (including the appropriate portion of a bundled fee) is affected by section 67(g) and thus is not deductible to the estate or nongrantor trust during the suspension of section 67(a). Nothing in section 67(g) impacts the determination of what expenses are described in section 67(e)(1).

Additionally, nothing in section 67(g) affects the ability of the estate or trust to take a deduction listed under section 67(b). These deductions remain outside of the definition of “miscellaneous itemized deduction.” For example, section 691(c) deductions (relating to the deduction for estate tax on income in respect of the decedent), which are identified in section 67(b)(7), remain unaffected by the enactment of section 67(g)).

The Treasury Department and the IRS intend to issue regulations clarifying that estates and non-grantor trusts may continue to deduct expenses described in section 67(e)(1) and amounts allowable as deductions under section 642(b), 651 or 661, including the appropriate portion of a bundled fee, in determining the
estate or nongrantor trust’s adjusted gross income during taxable years, for which the application of section 67(a) is suspended pursuant to section 67(g). Additionally, the regulations will clarify that deductions enumerated in section 67(b) and (e) continue to remain outside the definition of “miscellaneous itemized deductions” and thus are unaffected by section 67(g).

Section 642(h)(2) states that on termination of an estate or trust any deductions (other than the estate or trust exemption and other than the charitable deduction) for the estate or trust in excess of gross income are allowable as deductions to the beneficiaries. This deduction is eliminated due the suspension of miscellaneous itemized deductions for individuals under section 67(g). Beneficiaries may still claim a trust or estate’s net operating losses or capital loss carryovers upon trust or estate termination under section 642(h)(1).

Interestingly, the IRS is considering the consequence of an estate or trust terminating with unused expenses. Notice 2018-61 states:

The Treasury Department and the IRS are aware of some concerns that the enactment of section 67(g) will affect a beneficiary’s ability to deduct section 67(e) expenses upon the termination of the trust or estate as provided in section 642(h).

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

***

The section 642(h)(2) excess deduction may include expenses described in section 67(e). As previously discussed, prior to enactment of section 67(g), miscellaneous itemized deductions were allowed subject to the restrictions contained in section 67(a). For the years in which section 67(g) is effective, miscellaneous itemized deductions are not permitted, and that appears to include the section 642(h)(2) excess deduction. The Treasury Department and the IRS are studying whether section 67(e) deductions, as well as other deductions that would not be subject to the limitations imposed by sections 67(a) and (g) in the hands of the trust or estate, should continue to be treated as miscellaneous itemized deductions when they are included as a section 642(h)(2) excess deduction. Taxpayers should note that section 67(e) provides that appropriate adjustments shall be made in the application of part I of subchapter J of chapter 1 of the Code to take into account the provisions of section 67.

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

The Proposed Regulations, however, include provisions that would carry out the rule under section § 643(f) by preventing taxpayers from dividing trust assets among multiple trusts so that each trust has income below the threshold amount. Prop. Reg. § 1.643-1(f). The Proposed Regulations add that “the application of proposed §1.643(f)-1, however, is not limited to avoidance of the limitations under section 199A and proposed §§1.199A-1 through 1.199A-6.”

Most of the Proposed Regulations would apply to taxable years beginning after the Proposed Regulations are finalized. The anti-abuse provisions of the Proposed Regulations, however, would apply retroactively to taxable years ending after December 22, 2017, the date of enactment of the 2017 Tax Act. The regulations proposed under section § 643 would apply to taxable years ending after August 16, 2018, the date of publication of the Proposed Regulations in the Federal Register.

4. **Pease Limitation.** The limitation on otherwise allowable itemized deductions that applied to certain high-income taxpayers, often referred to as the “Pease” limitation, has been suspended. Section 68; 2017 Tax Act § 11046. Because the 2017 Tax Act suspended many itemized deductions, this suspension of the Pease limitation may be meaningful only to taxpayers who have substantial charitable or home mortgage interest deductions.

5. **State and Local Taxes.** The deduction for state, local and foreign real property taxes; state and local personal property taxes; and state, local and foreign income taxes (referred to as “SALT” deductions) is now limited to $10,000 per taxable year ($5,000 for a married taxpayer filing a separate return). These cap amounts are not indexed for inflation.

Deductions for state and local real property taxes; state and local personal property taxes; and foreign income taxes incurred in connection with trade or business or from an activity described in section 212 (i.e., investment activities) are not subject to this cap. The deduction for foreign real property taxes is suspended. Section 164(b)(6).

6. **Alimony and Separate Maintenance; trusts for Divorced Spouse.** The 2017 Tax Act eliminated the above-the-line deduction for alimony and separate maintenance payments under section 215. In addition, the 2017 Tax Act eliminated sections 61(a)(8) and 71, which required payees of alimony and separate maintenance to include such payments in gross income.
The 2017 Tax Act repealed section 682, which provided that if one spouse created a grantor trust for the benefit of the other spouse and the spouses divorced, thereafter the trust income would not be taxed to the grantor spouse to the extent of any income that the donee-spouse is entitled to receive.

These changes are effective for divorce decrees and separation agreements entered into after 2018. Thus, taxpayers seeking a divorce during 2018 will likely benefit if the divorce is finalized before the end of the calendar year. Modifications entered into after 2018 are subject to the 2017 Tax Act if the modification expressly states that this provision of 2017 Tax Act applies. 2017 Tax Act § 11051(c)(2). No sunset applies to the repeal of the above provisions regarding alimony and separate maintenance payments and section 682.

The IRS intends to issue regulations regarding the application of section 682 before its repeal is effective. Notice 2018-37. In the Notice, the IRS requested comments on whether guidance is needed regarding the application of sections 672(e)(1)(A), 674(d), and 677 following a divorce or separation in light of the repeal of section 682.

Section 672(e)(1)(A) provides that the grantor of a trust shall be treated as holding any power or interest in such trust held by any individual who was the spouse of the grantor at the time of the creation of such power or interest. Section 674(a) provides, in general, that the grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the trust assets is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party. However, section 674(d) provides that section 674(a) shall not apply to a power solely exercisable (without the approval or consent of any other person) by a Trustee or Trustees, none of whom is the grantor or spouse living with the grantor, to distribute, apportion or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries, if such power is limited by a reasonably definite external standard that is set forth in the trust instrument. Section 677(a) provides that the grantor of a trust shall be treated as the owner of any portion of a trust, whether or not the grantor is treated as such owner under section 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be distributed to the grantor or the grantor’s spouse, or held or accumulated for future distribution to the grantor or the grantor’s spouse. In light of the repeal of section 682, sections 672(e)(1)(A), 674(a) and 677(a) may have the effect of triggering grantor trust status due to the non-grantor spouse’s powers over a trust even after the spouses divorce. The comment date is July 11, 2018.

7. **Charitable Contributions.** The 2017 Tax Act enhanced the deduction for charitable contributions of cash to public charities, private operating foundations, supporting organizations and other entities described in section 170(b)(1)(A) by raising the limit that can be contributed in any one year to 60% of a taxpayer’s contribution base (generally, adjusted gross income) from 50%. Section 170(b)(1)(G)(i).
The 2017 Tax Act permanently removed all of the deduction relating to purchases of tickets to college sporting events. Contributions that are linked to the right to purchase such tickets will no longer be considered charitable donations. Section 170(l).

The 2017 Tax Act also eliminated the alterative rule for substantiating gifts to donee organizations. Previously, donors who made donations of $250 or more to donee organizations did not need a contemporaneous written acknowledgment from the donee organization if the donee organization filed a return with the required information. This change is effective for taxable years beginning after 2016. Section 170(f)(8).

8. **Unearned Income of Children (the “Kiddie Tax”).** The unearned income of children under 18 years of age (up to 23 years of age in certain circumstances) is now subject to the same ordinary income and capital gain tax brackets that are applied to trust and estate income. Section 1(j)(4). Some have suggested the actual calculations aren’t very simple. See “The Not-So-Simplified Kiddie Tax: A Primer,” Daily Tax Report (BNA), Joseph J. Ecuyer.

9. **Basis of Life Insurance Policies.** For purposes of life settlements of life insurance policies, the 2017 Tax Act provides that a taxpayer’s basis in a life insurance policy is not reduced by the cost of insurance. This provision reverses the IRS’s position, stated in Rev. Rul. 2009-13 that a taxpayer’s basis does include such charges. New reporting requirements are imposed for life settlements. Section 6050Y. The transfer for value rules are excluded from life settlements. Section 101(a)(2). These provisions do not sunset after 2025.

10. **Retirement Assets.** Prior law allowed individuals who converted a traditional IRA to a Roth IRA to reverse the conversion, move the assets back to the traditional IRA (the “recharacterized traditional IRA”) and avoid the income tax from a conversion if the conversion was reversed before the extended due date of the taxpayer’s individual income tax return for the year of the conversion. While continuing to allow the conversion to a Roth IRA, the 2017 Tax Act removed the ability to recharacterize the conversion. This provision does not sunset after 2025. Section 408A(d)(6)(B)(iii).

11. **ABLE Accounts.** An ABLE account is a tax-favored savings program to meet the qualified disability expenses of the beneficiary of the account. Once the overall limitation on contributions is reached for a calendar year ($15,000 for 2018), the 2017 Tax Act provides that the designated beneficiary of the ABLE account may contribute an additional amount to the ABLE account. The designated beneficiary’s contribution cannot exceed the lesser of the federal poverty line for one-person household or the designated beneficiary’s compensation for the year. Contributions to an ABLE account may be claimed as a saver’s credit on the designated beneficiary’s income tax return. The designated beneficiary, or the designated beneficiary’s representative, must maintain adequate records of any additional contribution by the designated beneficiary. Section § 529A, 25B.
12. **529 Plans.** The 2017 Tax Act permits owners of Section 529 accounts to rollover funds from such accounts to ABLE accounts, but only if the designated beneficiary (or member of the beneficiary’s family) of the Section 529 account owns the ABLE account. The amount rolled over is counted against the contribution limit that applies to the ABLE account for the year of the rollover. Section 529(c)(3)(C)(i)(III).

In addition, the 2017 Tax Act expanded the definition of “qualified higher education expense” to include up to $10,000 of the cost of enrollment or attendance at an elementary or secondary public, private, or religious school. This expansion of qualified higher education expense does not sunset. Section 529(c)(7), (e)(3)(A).

**E. Alternative Minimum Tax**

The corporate alternative minimum tax (“AMT”) has been repealed. Section 55(a). The 2017 Tax Act increased the exemption amounts applicable to individuals for AMT purposes. The AMT exemption amounts for unmarried individuals was increased from $54,300 to $70,300. The AMT exemption amounts for married individuals filing joint returns was increased to $109,400. Section 55(d). The exemption for estates and trusts is $24,600. Section 55(d)(1); Rev. Proc. 2018-18.

The 2017 Tax Act increased the amount by which the AMT begins to phase out. For married individuals filing joint returns, the phase out begins at $1,000,000 as opposed to $160,900 under prior law. For unmarried individuals, the phase out begins at $500,000 as opposed to $120,700 under prior law. Section 55(d); Rev. Proc. 2018-18. For estates and trusts, the phase-out begins at $81,900. Rev. Proc. 2018-22.

**F. Tax Exempt Organizations**

The 2017 Tax Act imposes an excise tax on highly compensated employees of tax-exempt organizations. The excise tax is imposed at a rate of 21% of compensation in excess of $1 million paid to any of the organization’s five highest-paid employees. The excise tax is paid by the organization and not the covered employee(s). The excise tax would also apply to certain parachute payments. Section 4960.

Where an employee of a foundation is also employed by a business and the two meet certain control tests, the business compensation would be considered when applying the section 4960 tax. Proposed regulations were issued on June 29, 2019. REG-106877-18.

The 2017 Tax Act also made changes to the unrelated business income tax (“UBIT”). Under prior law, tax-exempt entities could allocate gains and losses from one trade or business activity against the gains and losses from another trade or business activity for purposes of calculating UBIT. Under the new law, this is no longer possible as unrelated business income must be calculated separately for each activity. The result is that the losses generated by unrelated business income activities computed on a separate basis may not be used to offset the gains of other unrelated business income activities. This rule does not apply to net operating losses that arise in a year before 2018. Section 512(a)(6).
There are other UBIT changes including taxes on excess compensation. Of broad interest is section 512(a)(7), which increases UBTI by any amount for which section 274 would disallow a deduction but that is paid or incurred by a tax-exempt organization for any qualified transportation fringe (defined in section 132(f)), any parking facility used in connection with qualified parking (defined in section 132(f)(5)(C)), and on-premises athletic facilities (defined in section 132(j)(4)(B)) unless paid or incurred in direct connection with an unrelated trade or business. This provision is controversial and subject to much discussion.

G. Taxation of Businesses and Business Interests

1. Corporations. Corporations (subject to tax under Subchapter C of the Code) now pay a flat 21% income tax rate. Section 11(b). This rate change is permanent.

   The 80% dividend-received deduction has been reduced to 65%. The 70% dividends-received deduction was reduced to 50%. Sections 243, 245, 246, 246A.

2. Net Operating Losses. Net operating loss carryovers are now limited to 80% of taxable income, but such losses be carried forward indefinitely. For most businesses, the loss carryback has been eliminated. Section 172.

3. Nonresident Aliens and ESBTs. The TCJA allows a nonresident alien individual to be a potential current beneficiary of an electing small business trust. Section 1361(c)(2)(B)(v).

4. Deduction for Qualified Business Income. Introduction. The TCJA enacted new Internal Revenue Code section § 199A, which, in general, creates a deduction for the combined qualified business income received from certain pass-through and disregarded entities. This section does not apply to taxable years beginning after 2025. Section 199A(i).

   On August 8, 2018, the IRS issued proposed regulations under section 199A. REG-107892-18 (August 16, 2018). These regulations were finalized on January 18, 2019 and became effective after corrections on February 8, 2019. T.D. 9847. With the final regulations, the IRS issued new proposed regulations to provide guidance regarding previously suspended losses, regulated investment companies, charitable remainder trusts and split-interest trusts. REG-134652-18 (the “Newly Proposed Regulations”).

   For individuals, the deduction is available whether the individual claims the standard deduction or itemizes deductions. Section 63(b); Joint Explanatory Statement of the Committee of Conference on H.R. 1, 115th Cong. 1st Sess, p. 39 (2017). The deduction does not affect the calculation of adjusted gross income. Section 62(a); Akers, “Section 199A – Qualified Business Income Deduction Including Highlights of Final and Newly Proposed Regulations,” at http://www.bessemer.com (February 2019).
The deduction is available for individuals, partnerships, S corporations, estates, trusts and any other taxpayer other than a C corporation. Section 199A(a). The deduction is applied at the pass-through owner level. Section 199A(f)(1); Treas. Reg. § 1.199A-1(e)(1); -6. 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. Treas. Reg. § 1.199A-1(e)(1). The deduction is available for up to 20% of the taxpayer’s taxable income (without consideration of Section 199A) minus the taxpayer’s net capital gains (Section 1(h)). Net capital gain is defined as net capital gain under section 1221(11) and includes qualified dividend income. Treas. Reg. § 1.199A(b)(3). The deduction cannot exceed the combined qualified business income of the taxpayer. Section 199A(a), (e)(1).

The deduction is for income tax purposes only. It is not available to reduce self-employment tax under section 1402 or net investment income tax under section 1411. Section 199A(f)(3); Treas. Reg. § 1.199A-1(e)(3).

b. **Qualified Business Income.** In general, qualified business income (“QBI”) means the “deductible amount,” determined under section 199A(b)(2), for each qualified trade or business carried on by the taxpayer, plus 20% of qualified REIT dividends and qualified publicly traded partnership (“PTP”) income. Section 199A(b)(1), (c); Treas. Reg. § 1.199A-1(b)(5), -3(b).

The deductible amount is the lesser of: (a) 20% of the taxpayer’s QBI with respect to the qualified trade or business (defined below); or (b) the greater of 50% of the W-2 wages with respect to the qualified trade or business, or the sum of 25% of the W-2 wages with respect to the qualified trade or business plus 2.5% of the unadjusted basis immediately after acquisition of all qualified property (“UBIA”) ((b) is hereinafter referred to as the “Wage/UBIA Test”). Section 199A(b)(2); Treas. Reg. § 1.199A-1(d)(2)(iv). The Wage/UBIA Test is applied only if taxable income exceeds the threshold amount, discussed below. Section 199A(b)(3)(A); Treas. Reg. § 1.199A-1(c).

Generally, QBI consists of net income from an active trade or business within the United States, less qualified REIT dividends or qualified PTP income. It does not include, among other items, capital gains, dividends, non-business interest, wage income received as an employee, any guaranteed payment described in section 707(c) or payments to a partner for acting in a capacity other than a partner under Section 707(a). Section 199A(c); Treas. Reg. § 1.199A-3(b).

c. **Qualified Trade or Business; Specified Service Trade or Business; Trade or Business of Being an Employee.** A qualified trade or business is a trade or business other than: (a) a specified service trade or business (“SSTB”); or (b) the trade or business of being an employee. Section 199A(d)(1).

In general, a “trade or business” is defined in accordance with the provisions of section 162(a). Treas. Reg. § 1.199A-1(b)(14). The IRS issued a proposed revenue procedure, Notice 2019-03, to provide a safe harbor permitting a rental real estate enterprise to be treated as a trade or business. A trade or business conducted by a disregarded entity will be treated as conducted by the owner of that entity. Treas. Reg. § 1.199A-1(e)(2).
The exclusion for a SSTB applies only if the taxpayer’s taxable income is above the threshold amount, discussed below. These trades or businesses include those in the fields of law, health, accounting, financial services, actuarial science, performing arts, consulting, athletics, brokerage services, investment management or any business where the principal asset is the reputation or skill of one or more of its employees. Notwithstanding this provision, trades or businesses in the fields of engineering and architecture are considered qualified trades or businesses. Treas. Reg. § 1.199A-5(b).

If the trade or business is a SSTB and taxable income exceeds the phase-in range above the threshold amount, discussed below, none of the QBI, wages or UBIA for purposes of the Wage/UBIA Test will be taken into account in determining the taxpayer’s QBI, even if the item is derived from an activity that is not itself a SSTB. Section 199A(d)(2); Treas. Reg. § 1.199A-5(a).

The regulations provide that a trade or business is not considered a SSTB if it has gross receipts of $25 million or less per taxable year and less than 10% of such gross receipts is attributable to the performance of services in a SSTB. If gross receipts are greater than $25 million in a taxable year, the trade or business still would not be a SSTB if less than 5% of the gross receipts are attributable to the performance of services of a SSTB. Treas. Reg. § 1.199A-5(c)(1).

The regulations contain anti-abuse rules related to SSTBs. A trade or business, or the portion of a trade or business, that provides property or services to a SSTB also is considered a SSTB if there is 50% or more common ownership with the SSTB receiving such property or services. These rules are intended to prevent the division of a SSTB into a SSTB and a non-SSTB for the purpose of increasing the section 199A deduction. Treas. Reg. § 1.199A-5(c)(2).


If a taxpayer’s taxable income is above the threshold amount, and the Wage/UBIA Test results in an amount that is less than 20% of the QBI, then the deductible amount determined under section 199A(b)(2), discussed above, is reduced by a formula based on the taxable income in excess of the threshold amount. For 2019, if taxable income exceeds $210,700 ($421,400 for a taxpayer filing a joint return) the deduction under section 199A is unavailable. Section 199A(b)(3); Treas. Reg. § 1.199A-1(d)(2)(iv).

There is a second limitation based on the threshold amount that applies to a SSTB, defined above. If taxable income exceeds the threshold amount, only a certain percentage of items of income, gain, deduction or loss, and the W-2 wages and UBIA shall be used in determining the deductible amount, defined above. The percentage is determined by a formula that reduces the percentage based on the amount by which taxable income exceeds the
threshold amount. Once taxable income exceeds the threshold amount by $50,000 ($100,000 for taxpayer filing a joint return), the deduction is unavailable for the taxpayer’s interest in the SSTB. Section 199A(d)(3). The taxpayer’s interest in a SSTB may be subject to both the phase-out under section 199A(b)(3) and (d)(3). Treas. Reg. § 1.199A-1(d)(4)(vi), Ex. 6.

For wages to be taken into account, the wages must be properly allocable to QBI of one or more trades or businesses. Section 199A(b)(4); Treas. Reg. § 1.199A-2(b). The IRS has issued a revenue procedure, Rev. Proc. 2019-11, which provides three methods for calculating W-2 wages.

e. **Qualified Property.** Qualified property, which is taken into consideration in applying the Wage/UBIA Test, is tangible property subject to allowance for depreciation under section 167. The depreciable period for such property must not have ended before the close of the tax year. The property must be held by, and available for use in, the qualified trade or business at the close of the taxable year. The property must be used in the production of QBI. Section 199A(b)(6); Treas. Reg. § 1.199A-2(c).

To help prevent property transfers with the principal purpose of increasing the Section 199A deduction, the regulations contain an anti-abuse rule which provides that property would not be considered qualified property if the property is acquired within 60 days of the end of the taxable year and disposed of within 120 days without having been used in a trade or business for at least 45 days prior to disposition, unless the taxpayer demonstrates that the principal purpose of the acquisition and disposition was a purpose other than increasing the Section 199A deduction. Treas. Reg. § 1.199A-2(c)(1)(iv).

f. **Aggregation.** The regulations provide rules allowing a taxpayer with interests in related trades or businesses to combine their QBI, W-2 wages and UBIA for purposes of applying the Wages/UBIA Test. Aggregation is permitted, but not required. In general, the regulations provide that aggregation is permitted if the trades or businesses are under common control, integrated and provide similar products or services. The regulations provide family attribution rules for determining control. Aggregation is disallowed for SSTBs except as provided above pursuant to Treas. Reg. § 1.199A-5. Treas. Reg. § 1.199A-4.

g. **Multiple Owners or Beneficiaries.** For entities with multiple owners, each owner is allocated the owner’s allocable share of income, losses, basis and other items necessary to calculate the owner’s QBI deduction. Section 199A(f)(1); Treas. Reg. § 1.199A-6. With respect to a non-grantor trust or estate with multiple beneficiaries, each beneficiary’s portion of the trust or estate’s QBI, W-2 wages and UBIA is based on the proportion of such beneficiary’s portion of distributable net income (“DNI”), with any undistributed DNI used to determine the trust or estate’s QBI, W-2 wages and UBIA. Whether a trust or estate exceeds the threshold amount is determined after considering any distribution deduction. Treas. Reg. § 1.199A-6(d).
The regulations also provide that a trust formed with a principal purpose of avoiding, or of using more than one, threshold amount under section 199A will not be respected as a separate trust entity for purposes of determining the threshold amount. Treas. Reg. § 1.199A-6(d)(3)(vii).

The Newly Proposed Regulations provide that separate shares of a trust would be treated as a single trust for purposes of determining whether the taxable income of the trust exceeds the threshold amount. Prop. Reg. § 1.199A-6(d)(3)(iii).

h. **Regulations Under Section 643(f).** Section 643(f) provides that, for purposes of subchapter J of the IRC (sections 641-685), pursuant to regulations, two or more trusts shall be treated as one trust if: (1) such trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries; and (2) a principal purpose of such trust is the avoidance of the income tax. For purposes of section 643(f), spouses are treated as one person.

The regulations include provisions that implement the rule under section 643(f) by preventing taxpayers from dividing trust assets among multiple trusts so that each trust has income below the threshold amount. Treas. Reg. §1.643(f)-1.

i. **Effective Date of the Final and Newly Proposed Regulations.** Most of the regulations apply to taxable years ending after February 8, 2019. See, e.g., Treas. Reg. § 1.199A-1(f)(1). The anti-abuse provisions of the regulations, however, apply retroactively to taxable years ending after December 22, 2017, the date of enactment of the TCJA. See, e.g., Treas. Reg. § 1.199A-5(e)(1). The regulations under section 643(f) apply to taxable years ending after August 16, 2018, the date of publication of the Proposed Regulations in the Federal Register. Treas. Reg. § 1.643(f)-1(b). The Newly Proposed Regulations would apply to taxable years ending after the date the final regulations are published in the Federal Register, but taxpayers may rely on the Newly Proposed Regulations before that date.

5. **Charitable Gifts From Electing Small Business Trusts.** The TCJA also amends prior law to provide that the charitable contribution deduction allowed for the portion of an electing small business trust (“ESBT”) holding S corporation stock is determined under the rules applicable to individuals under section 170, and not those applicable to trusts under section 642(c). An ESBT holding S corporation stock is able to avoid the restrictions imposed by section 642(c), including the requirements that the contribution be made pursuant to the trust instrument and be made from gross income. An ESBT may now carry forward excess charitable deductions for five years. However, an ESBT will be subject to the same percentage limitations and substantiation requirements as individuals. These changes to ESBTs will not sunset.

6. **Carried Interests.** The TCJA imposes a three-year holding period on carried interests before becoming eligible for long-term capital gain treatment. Carried interests are referred to as “applicable partnership interests” and are defined as an interest held in connection with the performance of substantial services
by the taxpayer or related persons in an “applicable retained business.” Section 1061(c)(1). An “applicable retained business” consists of activities conducted on a regular, continuous and substantial basis related, in whole or in part, to (1) the raising or returning of capital and (2) either developing, or investing in or disposing of (or identifying for investing or disposition), assets such as securities, commodities, rental or investment real estate or cash or its equivalent. Section 1061(c)(2)&(3).

Applicable partnership interests do not include: (a) a partnership interest held by a corporation and (b) capital partnership interests that provide the partner with a right to share in partnership capital based on the amount of capital contributed or the value of such interest included in income under Section 83 upon the receipt or vesting of the interest. Section 1061(c)(4).

The new provision applies regardless of the application of section 83. Section 1061(a).

Treasury is authorized to promulgate regulations necessary to carry out the provisions of these provisions. Section 1061(f); Notice 2018-18.

PART 2 – ESTATE PLANNING PRACTICE IN 2018 AND BEYOND

I. WHERE WE ARE TODAY

A. New Planning Approaches

1. Given the large Applicable Exclusion Amount, it becomes clear that for many even traditional clients the estate tax has disappeared as an issue. This could change depending on political developments and is to change anyway on January 1, 2026; many clients are under $23 million but above $24 million.

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

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

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

5. The state of residence of the client and his or her beneficiaries will greatly affect the estate plan. In other words, if a client is domiciled in California, and his or her beneficiaries living in California, then dying with the assets may be the extent of the tax planning. On the other hand, if the beneficiaries live in a state like Texas that has no state income tax, then transferring the assets out of the estate during the lifetime of the client may be warranted. As a result, estate planners will need to ask clients two questions that, in the past, did not
significantly matter: (a) Where are you likely to be domiciled at your death? and (b) Naturally, at your death, your children, grandchildren, and other beneficiaries will be lovingly at your bedside, but where are they likely to be domiciled then?

B. Portability Planning

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

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

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

4. Of course, there are other considerations, including creditor protection, “next spouse” issues and potential “Medicaid” planning, which would favor by-pass trust planning. From a tax standpoint, the trade-off is the potential estate tax savings of traditional by-pass trust planning against the potential income tax savings of portability planning. Because the DSUE Amount does not grow with the cost-of-living index, very large estates will benefit more with traditional by-pass trust planning because all of the assets, including any appreciation after the decedent’s death, will pass free of transfer taxes. On the other hand, smaller but still significant estates should consider portability as an option because the combined exclusions -- the DSUE Amount frozen but the surviving spouse’s Applicable Exclusion Amount growing with the cost-of-living index -- is likely to allow the assets to pass at the surviving spouse’s death with a full step-up in basis with little or no transfer tax costs (unless the assets are subject to significant state death taxes at that time).
Estates where a surviving spouse may need to qualify for government assistance should consider a modified by-pass trust type planning; the trust for the surviving spouse is designed specifically with governmental assistance in mind. For example, perhaps a child or other person should be allowed to terminate the spouse’s interest in the trust (or otherwise modify it). Consider a trust “for” the surviving spouse in which the descendants are beneficiaries. A trusted child or other person could have a lifetime special power of appointment in favor of anyone; that power would be exercised every month, quarter, or year in favor of the spouse until that was inappropriate. The spouse would say accurately that no trusts were for his or her benefit. For Medicaid purposes, trusts under Will are favored over trust agreements.

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

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

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

A. Generally

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

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

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

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

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

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

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

B. Swapping Assets with Existing Grantor Trusts

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

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

3. To maximize the benefits of the swap power, it must be exercised as assets appreciate or are sold over time. When exercised properly, this can ensure that only those assets that benefit the most from the step-up will be subject to estate inclusion.
a. If grantor does not have sufficient other assets, repurchase will be difficult - although the donor could borrow cash from a third party. What are the results if cash is borrowed by the grantor, the grantor buys assets from the trust, the trust loans the cash back to the grantor, the grantor pays back the third party lender and, at death, the grantor’s estate satisfies the note to the trust with assets having fair market value basis?

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

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

C. Should Valuation Discounts Be Undone?

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

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

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

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

   c. The ability of the IRS to ignore provisions of an agreement that increase the value of assets in the hands of a parent, but not in the hands of a child, is uncertain. By its literal terms, section 2703 of the Code applies only to provisions that reduce value and to restrictions on the right to sell or use property. To illustrate, in Estate of James A. Elkins, Jr., et al. v. Commissioner, 140 T.C. No. 5 (2013), the Tax Court applied section 2703 to ignore a family co-tenancy agreement requiring all owners of fractional interests in art to agree before the art could be sold. The purpose of that agreement was to limit the marketability of a fractional interest.
But what might the effect on value be of an agreement which provided, instead, that any fractional owner could compel the sale of the entire asset? Similarly, a provision that allowed a shareholder in business to put stock to the business at death for fair market value would seem to be outside the scope of the section. In many instances, amending old agreements to include such provisions will be more likely to create gift from the younger owners to the older than would terminating an old agreement and creating a new one.

D. Powers of Appointment For Basis Purposes

1. Generally

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

[footnotes omitted]
The 1977 opinion renders an identical holding, bolstered by certain legislative history:

There is nothing in the record to show that the trustees could not have undertaken exclusive control of the trust res if they had elected to do so. Whatever power Goodwyn exercised over the trust assets, administration or distribution, he did so on the trustee's behalf and not in his own right.

Because of Goodwyn's failure to have a legally enforceable right, we have already held, following Byrum, that the assets of these trusts were not includable in the decedent's estate under 2036(a)(2). Since a similar legal right or power is a prerequisite under section 674(a), consistency appears to require the same decision with respect to the applicability of this section. We see no other possible decision.

Section 671 precludes attributing the income to Goodwyn on any other theory of dominion and control under the definition of gross income, including the Clifford doctrine. We interpret this limitation to mean that if Goodwyn cannot be considered as a trustee, in fact, under the statutory provisions of subpart E, he cannot be considered as such by virtue of the judicial doctrines arising from the Clifford case which Congress intended to limit through the enactment of subpart E. But the protection of section 671, as explained in the House Ways and Means Committee Report, cited supra, does not extend to situations involving the assignments of future income.

With respect to the legislative history of the 1954 Code, the 1977 opinion states:

While the record indicates that the legal formalities have been complied with, it also indicates that the designated "independent" trustees, whether by agreement or otherwise, entrusted the management of the trusts' assets and the distribution of income therefrom to the sole discretion of the decedent. The decedent kept all the records, made all of the investments and decided the amount to be distributed to beneficiaries. The trustees merely acquiesced in these actions.

On the basis of these facts, the judicial decisions following the Supreme Court's decision in Helvering v. Clifford [40-1 USTC ¶ 9265], 309 U.S. 331 (1940), and the later so-called Clifford regulations might well warrant the attribution of the income from these trusts to the decedent. However, to the extent these previous principles are not embodied in the present statutory provisions of the Code, they must be considered no longer applicable. Section 671 provides that subpart E represents the sole criterion of dominion and control under section 61 (relating to the definition of gross income) and thereby also under the Clifford doctrine.

The Report of the Committee on Ways and Means on the Internal Revenue Code of 1954 explains clearly that this exclusivity was the intent of Congress:

It is also provided in this section [671] that no items of a trust shall be included in computing the income or credits of the grantor (or another person) solely on the grounds of his dominion and control over the trust under the provisions of section 61 (corresponding to sec. 22(a) of existing law). The effect of this provision is to insure that taxability of Clifford type trusts shall be governed solely by this subpart. However, this provision does not affect the principles governing the taxability of income to a grantor or assignor other than by reason of his dominion and control over the trust. Thus, this subpart has no application in situations involving assignments of future income to the assignor, as in Lucas v. Earl [2 USTC ¶ 496] (281 U.S. 111), Harrison v. Schaffner [41-1 USTC ¶}
Consequently, in order for a grantor to be held taxable pursuant to subpart E on the income of a trust which he has established, he must have one of the powers or retained interests proscribed by subpart E.

So, that’s where the law has stood for many years. Along comes a bad facts makes bad law case, that of Securities and Exchange Commission v. Wyly, 2014 WL 4792229 (S.D.N.Y. Sept. 25, 2014). The issue there was whether certain trusts should be considered grantor trusts for income tax purposes, thus causing the grantors to owe income tax, or whether the trusts were properly considered to be offshore, managed by an Isle of Man trustee. The court did not follow the Goodwyn cases holding that the “independent” trustees were not independent at all. Wyly reminds us to follow the form of transactions:

The evidence amply shows that the IOM trustees followed every Wyly recommendation, whether it pertained to transactions in the Issuer securities, making unsecured loans to Wyly enterprises, or purchases of real estate, artwork, collectibles, and other personal items for the Wylys and their children. The trustees made no meaningful decisions about the trust income or corpus other than at the behest of the Wylys. On certain occasions, such as the establishment of the Bessie Trusts, the IOM trustees actively participated in fraudulent activity along with the Wylys. The Wylys freely directed the distribution of trust assets for personal purchases and personal use. Because the Wylys and their family members were beneficiaries, the IOM trustees were thus “distributing” income for a beneficiary at the direction of the grantors—the Wylys.

The Goodwyn rule was clear, but if you believe Wyly then in many trusts we would likely discover that the grantor or beneficiaries were “pulling the strings” although they had no legal right to do so. An additional consideration is what effect does a non-fiduciary holding a power to direct a trustee have for tax purposes. The Goodwyn rationales appear to be based on a trustee having authority; if an advisor who is not a fiduciary can direct a trustee, and the trustee must follow the direction, then will Goodwyn protect the grantor whose advisor follows the grantor’s advice regularly. Similarly, where a grantor gives an inter vivos power of appointment to someone during the grantor's lifetime the Goodwyn rationale is inapplicable.

3. Power to Grant or Modify a Power. Give someone - - trustee, advisory committee, or trust protector - - the discretion to grant a general power of appointment or to expand a special power of appointment so that it becomes general. The power could be granted shortly before death if the step up in basis is desirable given the tax rates in effect at that time (considering, of course, that when a potential power holder is “shortly before” death may not always be easy to determine). Should the person with the power to grant or expand the power be a fiduciary? Should protection be given for a decision to grant or not to grant the power of appointment? Should the general power be able to be rescinded or modified by the person granting the power?
Where the circumstances are clearly defined, a formula grant of a general power may be easier, and more successful, that a broadly applicable formula. Again, the general power may lapse and still cause inclusion depending on the trust terms and whether the powerholder is a beneficiary.

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

4. Tax consequences of estate tax inclusion

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

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

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

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

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

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

1. Generally

   a. Many clients who have taxable estates also have a surviving parent or parents (or grandparent) who lack a taxable estate. A child of a parent whose taxable estate is less than the parent’s Applicable Exclusion Amount may make use of the excess to save income, estate, and generation skipping taxes if the child can transfer assets upstream, from child to parent, in such a way that the assets are included in the parent’s estate with little likelihood that the parent will divert the transferred assets away from the child or child’s descendants.

   b. Although the benefits of such planning have always existed, the permanent increase in the Applicable Exclusion Amount has enhanced the benefits of such planning.

2. Estate and Generation Skipping Tax Benefits.

   a. To the extent a child transfers assets to an ancestor, the ancestor will include those assets in the ancestor’s estate and may shelter those assets with the ancestor’s estate and GST tax exemptions. Transfers can be made without using the child’s Applicable Exclusion Amount:

      (1) Annual exclusion gifts may be made to the ancestors. The gifts may be made outright or in trust depending on circumstances (e.g. ancestors may be given Crummey withdrawal rights). Discounted gifts may be made although doing so will add benefits to the transaction only if the discount is unlocked prior to the ancestor’s death. The benefits of annual exclusion gifts may be significant.

      (2) Child could make adjusted taxable gifts to the ancestor. Although it may appear that such would be a wasted use of the child’s gift tax exemption, if the ancestor is able to leave the $1,000,000 to child and child’s descendants without estate or generation-skipping tax then the only waste would be opportunity cost to the extent that other methods could be found to transfer assets to a parent without making a gift.

      (3) Child may create a GRAT that has a vested remainder in ancestor. That is, the GRAT assets, after the annuity term ends, will be paid to ancestor or to ancestor’s estate. The value of the remainder will be included in the ancestor’s estate and will pass in accordance with the ancestor’s estate plan.

The ancestor’s executor may allocate generation-skipping tax exemption to the remainder interest without regard to any ETIP under section 2642(f) of the Code because the ancestor has not made an inter vivos transfer of property that would be included in the estate immediately after the transfer. The amount allocated would be equal to the fair market value of the remainder interest. Where the GRAT term is 10 years (or longer), and is back-weighted, the remainder value will remain a comparatively small percentage of the GRAT for the first several years of the term. Upstream GRATs will, in general, have longer terms that GRATs that are designed to transfer assets
immediately to children. Commentators have speculated that a GRAT may be created with a vested interest in a child, with that child immediately transferring the remainder interest to that child’s children and allocating that child’s GST exemption at the time of transfer. There is no authority on whether such a transaction achieves the intended result. PLR 200107015 ruled negatively on the assignment of a remainder interest in a charitable lead annuity trust primarily on the grounds that section 2642(e) of the Code is specifically designed to limit the ability to leverage generation skipping tax exemption by using a charitable lead annuity trust. Here the GRAT remainder is not being transferred at the time of its creation, but rather at its fair market value at a later time (the death of the parent owner), which is not abusive. Suppose the GRAT remainderman is an LLC; could the LLC be transferred more easily than as a remainder interest.

Use of an Upstream GRAT presents several advantages compared with a child’s assignment of a remainder interest to grandchildren. Because GST exemption that would otherwise be wasted is being used there is no, or certainly less, pressure to keep the remainder interest in parent’s estate at zero or a de minimis value and the value changes depending on when parent dies (a date that in almost all instances will be uncertain). If a concern is that the value of the remainder interest could exceed the threshold beyond which parent’s estate would be required to pay Federal estate tax (or file an estate tax return), then the amount vested in parent could be fixed by a formula tied to the remaining assets in parent’s estate. Suppose a 10 year GRAT is funded with $1,000,000 with annual payments that increase at 20% per year is created in a month when the section 7520 rate is 2.0%. The annual payments required to zero-out the GRAT are $44,125. Further, suppose that parent dies at the end of year 5 when the section 7520 rate is 5.0% and the value of the trust assets have grown at 6% per year. The value of the GRAT will be $975,740 with five years of payments remaining and the value of the remainder will be about $403,000.

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

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

Does the existence of the parent’s general power cause the assets to be stepped up to full fair market value, or will the value of the note reduce the amount of the step-up? Section 2053(a)(4) provides that the value of the taxable estate will be reduced by indebtedness in respect of property included in a decedent’s estate. Treas. Reg. § 20.2053-7 provides in relevant part:
A deduction is allowed from a decedent’s gross estate of the full unpaid amount of a mortgage upon, or of any other indebtedness in respect of, any property of the gross estate, including interest which had accrued thereon to the date of death, provided the value of the property, undiminished by the amount of the mortgage or indebtedness, is included in the value of the gross estate. If the decedent’s estate is liable for the amount of the mortgage or indebtedness, the full value of the property subject to the mortgage or indebtedness must be included as part of the value of the gross estate; the amount of the mortgage or indebtedness being in such case allowed as a deduction. But if the decedent’s estate is not so liable, only the value of the equity of redemption (or the value of the property, less the mortgage or indebtedness) need be returned as part of the value of the gross estate. In no case may the deduction on account of the mortgage or indebtedness exceed the liability therefore contracted bona fide and for an adequate and full consideration in money or money’s worth.

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

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

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

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

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

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

**Example 4.** A creates and funds a trust, T. A does not retain any power or interest in T that would cause A to be treated as an owner of any portion of the trust under sections 671 through 677. B holds an unrestricted power, exercisable solely by B, to withdraw certain amounts contributed to the trust before the end of the calendar year and to vest those amounts in B. B is treated as an owner of the portion of T that is subject to the withdrawal power under section 678(a)(1). However, B is not a grantor of T under paragraph (e)(1) of this section because B neither created T nor made a gratuitous transfer to T.

**Example 8.** G creates and funds a trust, T1, for the benefit of B. G retains a power to revest the assets of T1 in G within the meaning of section 676. Under the trust agreement, B is given a general power of appointment over the assets of T1. B exercises the general power of appointment with respect to one-half of the corpus of T1 in favor of a trust, T2, that is for the benefit of C, B’s child. Under paragraph (e)(1) of this section, G is the grantor of T1, and under paragraphs (e)(1) and (5) of this section, B is the grantor of T2.

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

3. **Income Tax Benefits**

   a. Assets included in a parent’s estate for estate tax purposes obtain a new income tax basis under section 1014(b)(9) but not if assets acquired by the parent from a child by gift within one year of the parent’s death pass back to the child or the child’s spouse (§1014(e)). Suppose that the assets pay into a trust for descendants only but a third party has a power of appointment to add beneficiaries to the trust?
Depreciable property has special issues. Section 1014(b)(9) limits the basis adjustment for depreciation taken by a taxpayer other than the decedent. Because the UPSTAT will remain a grantor trust as to the younger generation grantor who originally took the depreciation deduction, after the death of the older generation holder of the general power of appointment, then the amount of the basis adjustment might be reduced by the amount of the depreciation deductions allowed to the younger generation grantor prior to the older generation member’s death.

Treas. Reg. §1.1014-6 states:

(a) In general.

(1) The basis of property described in section 1014(b)(9) which is acquired from a decedent prior to his death shall be adjusted for depreciation, obsolescence, amortization, and depletion allowed the taxpayer on such property for the period prior to the decedent's death. Thus, in general, the adjusted basis of such property will be its fair market value at the decedent's death, or the applicable alternate valuation date, less the amount allowed (determined with regard to section 1016(a)(2)(B)) to the taxpayer as deductions for exhaustion, wear and tear, obsolescence, amortization, and depletion for the period held by the taxpayer prior to the decedent's death. The deduction allowed for a taxable year in which the decedent dies shall be an amount properly allocable to that part of the year prior to his death. For a discussion of the basis adjustment required by section 1014(b)(9) where property is held in trust, see paragraph (c) of this section.

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

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

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

4. **Creditor Protection for Child**

a. Assets that a parent transfers in trust to a child may be insulated from the child’s creditors so long as the child’s rights in the trust are properly limited. The sine qua non is that parent must make the transfer into the trust for state law purposes.

b. The lapse of a Crummey withdrawal right may be a state law transfer, although most practitioners and trustees do not treat it as such, except in those states which provide specifically to the contrary (such as under the Uniform Trust Code). A safer approach would be to have parent exercise parent’s power.
of appointment in favor of a new trust for the benefit of child. If the power is general the parent should become the grantor of the trust for state law purposes.

5. Limiting Parent’s Ability to Divert Assets
   a. The strategies called for require that parent have a testamentary general power of appointment. A power limited to the appointment of assets to the creditors of a parent’s estate will be a general power under section 2041(b)(1). If it is desirable that a parent have additional discretion the parent could be given a power to appoint to descendants, with or without charities, and such additional powers could be conditioned on the consent of child or others because all that is required in order to capture the tax benefits is the limited testamentary general power.
   b. If a child desires to receive an interest in the assets transferred to parent back from parent (e.g. parent transfers the assets into a trust for child and child’s descendants that is not available to child’s creditors), then giving parent a power that is broader than a power to appoint to the creditors of parent’s estate may be desirable. For example, a parent could be given a power to appoint to parent’s children and the creditors of parent’s estate. Child could ensure that assets were not diverted to a sibling by purchasing from the siblings an assignment of any rights the siblings receive in assets appointed by parent that originated with child. The assignment would be independent of parent but would limit the ability of a creditor (or the government) to argue that the child transferred the assets to parent in a manner that did not give parent any true control. The ability to reach such an agreement with minors is limited.

   a. A parent who has or is likely to have creditors will not be a good candidate for these sorts of transactions. Creditors could include health-care providers or Medicaid, tort victims (for example, if parent is still driving), and beneficiaries of legally binding charitable pledges.
   b. In addition, by definition, a parent who is married to someone who is not also child’s parent has a potential creditor at death although in limited instances marriage agreements coupled with state law limitations on the rights of a surviving spouse to take property over which a decedent has a testamentary general power of appointment may make these transactions feasible.

PART 3 – FEDERAL RULINGS, CASES AND OTHER DEVELOPMENTS

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

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

A. Section 1014(f)

Section 1014(f) imposes an obligation of consistency between the basis of certain inherited property and the value of that property for Federal estate tax purposes.

Section 1014(f)(1) provides that the basis of property acquired from a decedent cannot exceed that property's final value for purposes of the Federal estate tax imposed on the estate of the decedent, or, if the final value has not been determined, the value reported on a statement required by section 6035(a).

Section 1014(f)(2) provides that section 1014(f)(1) only applies to property the inclusion of which in the decedent's gross estate increased the estate's liability for the Federal estate tax (reduced by credits allowable against the tax).

Section 1014(f)(3) provides that, for purposes of section 1014(f)(1), the basis of property has been determined for Federal estate tax purposes if (A) the value of the property is shown on a return under section 6018 and that value is not contested by the Secretary before the expiration of the time for assessing the estate tax; (B) in a case not described in (A), the value is specified by the Secretary and that value is not timely contested by the executor of the estate; or (C) the value is determined by a court or pursuant to a settlement agreement with the Secretary.

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

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

(2) Exclusions. For purposes of paragraph (b)(1) of this section, property that qualifies for an estate tax charitable or marital deduction under section 2055, 2056, or 2056A, respectively, does not generate a tax liability under chapter 11 and therefore is excluded from the property subject to the consistency requirement in paragraph (a)(1) of this section. For purposes of paragraph (b)(1) of this section, tangible personal property for which an appraisal is not required under § 20.2031-6(b) is deemed not to generate a tax liability under chapter 11 and therefore also is excluded from the property subject to the consistency requirement in paragraph (a)(1) of this section.
(3) Application. For purposes of paragraph (b)(1) of this section, if a liability under chapter 11 is payable after the application of all available credits (other than a credit for a prepayment of estate tax), the consistency requirement in paragraph (a)(1) of this section applies to the entire gross estate (other than property excluded under paragraph (b)(2) of this section) because all such property contributes to the liability under chapter 11 and therefore is treated as generating a tax liability under chapter 11. If, however, after the application of all such available credits, no tax under chapter 11 is payable, the entire gross estate is excluded from the application of the consistency requirement.

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

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

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

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Section 1014(f)(3) provides that, for purposes of section 1014(f)(1), the final value of property has been determined for Federal estate tax purposes if: (A) The value is reported on a Federal estate tax return filed with the IRS and is not contested by the IRS before the period of limitation on assessment expires; (B) the value is specified by the IRS and is not timely contested by the executor of the estate; or (C) the value is determined by a court or pursuant to a settlement agreement with the IRS.

Proposed § 1.1014-10(c)(1) defines the final value of property that is reported on a Federal estate tax return filed with the IRS. That value is the value reported on the Federal estate tax return once the period of limitations on assessment for adjusting or contesting that value has expired. The IRS may specify a value for the property by determining a value in the course of carrying out its responsibilities under section 7803(a)(2). If the IRS determines a value different from the value reported, the final value is the value determined by the IRS once that value can no longer be contested by the estate. If the value determined or specified by the IRS is timely contested by the estate, the final value is the value determined in an agreement that is binding on all parties, or the value determined by a court once the court's determination is final.
Proposed § 1.1014-10(c)(2) provides that the recipient of property to which the consistency requirement applies may not claim a basis in excess of the value reported on the statement required to be furnished under section 6035(a) (the value shown on the Federal estate tax return) if the taxpayer's basis in the property is relevant for any purpose under the Internal Revenue Code before the final value of that property has been determined under proposed § 1.1014-10(c)(1). However, under section 1014(f)(1), basis cannot exceed the property's final value. Therefore, proposed § 1.1014-10(c)(2) provides that, if the final value is determined before the period of limitation on assessment expires for any Federal income tax return of the recipient on which the taxpayer's basis is relevant and the final value differs from the initial basis claimed with respect to that return, a deficiency and an underpayment may result.

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

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

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

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

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

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

(ii) No return under section 6018 filed. If no return described in section 6018 has been filed, and if the inclusion in the decedent's gross estate of the after-discovered or omitted property would have generated or increased the estate's tax liability under chapter 11, the final value, for purposes of section 1014(f), of all property described in paragraph (b) of this section is zero until the final value is determined under paragraph (c)(1) or (2) of this section. Specifically, if the executor files a return pursuant to section 6018(a) or (b) that includes this property or the IRS determines a value for the property, the final value of all
property described in paragraph (b) of this section includible in the gross estate then is determined under paragraph (c)(1) or (2) of this section.

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

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

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

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

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

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

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

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

10. Beneficiaries

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

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

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

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

As discussed earlier in this preamble, section 6035(a)(2) imposes a reporting requirement on the executor of the decedent's estate and on any other person required to file a return under section 6018. The purpose of this reporting is to enable the IRS to monitor whether the basis claimed by an owner of the property is properly based on the final value of that property for estate tax purposes. The Treasury Department and the IRS are concerned, however, that opportunities may exist in some circumstances for the recipient of such reporting to circumvent the purpose of the statute (for example, by making a gift of the property to a complex trust for the benefit of the transferor's family).

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

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

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

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

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

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

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

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

The timing requirements of supplemental reporting is strict:

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

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

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

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

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

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

There are penalty provisions as well described by the summary:

Section 2004(c) of the Act added a new accuracy-related penalty for underpayments attributable to an inconsistent estate basis. See section 6662(b)(8).

Section 6662(k) provides that there is an inconsistent estate basis if the basis of property claimed on a return exceeds the basis as determined under section 1014(f).

Section 2004(c) of the Act adds statements under section 6035 to the list of information returns and payee statements subject to the penalties under section 6721 and section 6722, respectively. Specifically, the Act adds new paragraph (D) to section 6724(d)(1) to provide that the term information return means any statement required to be filed with the Secretary under section 6035. The Act also adds new paragraph (II) to section 6724(d)(2) to provide that the term payee statement means any statement required to be furnished under section 6035 (other than a statement described in section 6724(d)(1)(D)).

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

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

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

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

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

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

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

The Court’s emphasis on these factors emerged in two early cases, Safe Deposit & Trust Co. of Baltimore v. Virginia, 280 U.S. 83 (1929), and Brooke v. Norfolk, 277 U.S. 27 (1928), both of which invalidated state taxes premised on the in-state residency of beneficiaries. In each case the challenged tax fell on the entirety of a trust’s property, rather than on only the share of trust assets to which the beneficiaries were entitled.

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On the other hand, the same elements of possession, control, and enjoyment of trust property led the Court to uphold state taxes based on the in-state residency of beneficiaries who did have close ties to the taxed trust assets. The Court has decided that States may tax trust income that is actually distributed to an in-state beneficiary. In those circumstances, the beneficiary “own[s] and enjoy[s]” an interest in the trust property, and the State can exact a tax in exchange for offering the beneficiary protection. Maguire, 253 U.S., at 17; see also Guaranty Trust Co. v. Virginia, 305 U. S. 19, 21–23 (1938).

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

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

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

There is a dizzying array of possible state income tax outcomes for nongrantor trusts depending on the subject trust's facts and circumstances. For example:
• If the trust was established by the will of a testator who resided in a state whose laws impose the testator residence test ("State A"), or if the trust, irrevocable from the moment of establishment, was established, by an inter vivos instrument, by a settlor who resided in a state whose laws impose the settlor residence test, the trust will be considered a resident of that state, and so will be subject to that state's income tax regime, indefinitely, regardless of the presence (or lack thereof) of any other factors. See, for example, Me. Rev. Stat. Ann. Tit. 36, §5102(4)(B),(C); Neb. Rev. Stat. §77-2714.01(6)(b),(c).

• If the trust is administered in a state whose laws impose the place of administration test ("State B"), the trust will be considered a resident of that state, and so will be subject to that state's income tax regime, for as long as the trust continues to be administered in that state, regardless of the presence (or lack thereof) of any other factors. See, for example, Colo. Rev. Stat. §39-22-103(10); S.C. Code Ann. §12-6-30(5).

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

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

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

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

The Kaestner opinion doesn’t answer what connections may pass muster if beneficiary residence alone is insufficient. Instead, the Court simply said that the test will be the same for any “position” within a trust. The Court states:
In sum, when assessing a state tax premised on the in-state residency of a constituent of a trust—whether beneficiary, settlor, or trustee—the Due Process Clause demands attention to the particular relationship between the resident and the trust assets that the State seeks to tax. Because each individual fulfills different functions in the creation and continuation of the trust, the specific features of that relationship sufficient to sustain a tax may vary depending on whether the resident is a settlor, beneficiary, or trustee.

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

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

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

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

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

First, the court held that settlor’s residence at the time the trusts became irrevocable was “not relevant to the relationship between the Trusts’ income that Minnesota seeks to tax and the protection and benefits Minnesota provided to the Trusts’ activities that generated that income. The relevant connections are Minnesota’s connection to the trustee, not the connection to the grantor who established the trust years earlier.” Thus, the court looked largely to the trusts’ independence as a legal entity, separate from the settlor or beneficiary.
Second, the trusts owned no physical property in Minnesota that might serve as a basis of taxation. The
trusts owned stock of a Minnesota company, intangible property, but that intangible property was held outside
Minnesota.

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

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

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

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

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

State Statute provides, in relevant part, that matters that may be resolved by a
nonjudicial settlement include termination of the trust, provided that court
approval of such termination is obtained in accordance with this section, and the
court must conclude that continuance of the trust is not necessary to achieve any
material purpose of the trust. State Statute further provides that upon such
termination, the court may order the trust property distributed as agreed by the
parties to the agreement or otherwise as the court determines is equitably
consistent with the purposes of the trust.
On Date 2, Son, the Current Remaindermen and the Successor Remaindermen entered into Agreement. Agreement states that the continuance of Trust “is no longer necessary to achieve any clear material purpose of such trust because [Son]’s net worth has grown significantly, such that he does not need income from [Trust] for his support.” Agreement further provides for the termination of Trust and the distribution of Trust's assets among Son, the Current Remaindermen and the Successor Remaindermen in accordance with the actuarial value of each beneficiary's share (Proposed Distribution),

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

Rev. Rul. 72-243, 1972-1 C.B. 233, provides that the proceeds received by the life tenant of a trust, in consideration for the transfer of the life tenant's entire interest in the trust to the holder of the remainder interest, are treated as an amount realized from the sale or exchange of a capital asset under § 1222. The right to income for life from a trust estate is a right in the estate itself. See McAllister v. Commissioner, 157 F.2d 235 (2d Cir. 1946), cert. denied, 330 U.S. 826 (1947).

In Rev. Rul. 69-486, 1969-2 C.B. 159, a non-pro rata distribution of trust property was made in kind by the trustee, although the trust instrument and local law did not convey authority to the trustee to make a non-pro rata distribution of property in kind. The distribution was effected as a result of a mutual agreement between the trustee and the beneficiaries. Because neither the trust instrument nor local law conveyed authority to the trustee to make a non-pro rata distribution, Rev. Rul. 69-486 held that the transaction was equivalent to a pro rata distribution followed by an exchange between the beneficiaries, an exchange that required recognition of gain under § 1001.

Although the proposed transaction takes the form of a distribution of the present values of the respective interests of Son, the Current Remaindermen, and the Successor Remaindermen, in substance it is a sale of Son's and the Successor Remaindermen's interests to the Current Remaindermen. Rev. Rul. 69-486.

The amounts received by Son as a result of the termination of Trust are amounts received from the sale or exchange of a capital asset to the Current Remaindermen. Rev. Rul. 72-243. Because Son's basis in the income interest of Trust is a portion of the entire basis of the property under § 1015(b), and because the disposition of Son's term interests is not part of a transaction in which the entire interest in Trust is transferred to a third party, Son's adjusted basis in Son's interest in Trust is disregarded under § 1001(e). Son's holding period in the life interests in Trust exceeds one year. Accordingly, based on the facts submitted and representations made, the entire amount realized by Son as a result of the early termination of Trust will be long-term capital gain under § 1222(3).

Similarly, the amounts received by the Successor Remaindermen as a result of the termination of Trust are amounts received from the sale or exchange of a capital asset to the Current Remaindermen. Cf. Helvering v. Gambrill, 313 U.S. 11, 15 (1941), 1941-1 C.B. 364 (The phrase “property held by the taxpayer” under a prior law holding period rule relating to capital gains and losses includes not only full ownership, but also any interest owned whether vested, contingent, or conditional). The Successor Remaindermen's holding period in their interests in Trust also exceeds one year. Accordingly, under § 1222(3), the gain
determined under § 1001(a) by the Successor Remaindermen as a result of the early termination of Trust will be long-term capital gain.

In addition, to the extent that a Current Remainderman exchanges property, including property deemed received from Trust, for the interests of Son and the Successor Remaindermen, the Current Remainderman will recognize gain or loss on the property exchanged. Accordingly, based on the facts submitted and representations made, for purposes of determining gain or loss, the amount realized by each Current Remainderman on the exchange of property for Trust interests held by Son and the Successor Remaindermen will be equal to amount of cash and fair market value of the trust interests received in exchange for the transferred assets. Section 1.1001-1(a) and Rev. Rul. 69-486.

Suppose the parties had amended the trust to add principal distribution provisions. Would that have been a gift by the consenting parties, even prior to an actual distribution? Would that have altered the result of the ruling?

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

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

1. Charitable Distributions From Trusts. Suppose a trust does not provide for distribution to charity but the beneficiaries desire such distributions to occur. If the trust is modified validly under state law to allow charitable distributions, will that allow the trust to take a section 642(c) deduction? In CCA 2016-01-013 the IRS concluded no because the trust after modification was not the “governing instrument.” The ruling states:

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

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

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

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

In Lyeth v. Hoey, 305 U.S. 188 (1938), the Supreme Court held that property received in the settlement of a bona fide will contest is treated for federal income tax purposes as passing to the beneficiaries by inheritance. In Middleton v. United States, 99 F.Supp. 801 (D.C. Pa. 1951), the court held, applying principles derived from Lyeth, that amounts distributed to a charity pursuant to an agreement compromising a will contest were made "pursuant to the terms of the will." The court concluded that the income from the property that was distributed to the charity was permanently set aside for a charitable purpose and allowed a deduction for these amounts for the years prior to the year that the parties entered into the settlement agreement. See also Estate of Wright v. United States, 677 F.2d 53 (9th Cir. 1982), cert. denied, 459 U.S. 909 (1982).

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

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

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

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

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

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

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

Sections 661(a), 663(a)(2), and 663(c) were enacted as part of the original Internal Revenue Code of 1954. The only subsequent change relevant to the current issue was the amendment of § 663(c) by § 1307 of the Taxpayer Relief Act of 1997, P.L. 105-34, to apply to estates as well as trusts. Section 642(c), discussed under Issue 1, was also included in the original Code, and was bifurcated by § 201 of the Tax Reform Act of 1969, P.L. 91-172, into current §§ 642(c)(1) and (2), dealing respectively with deductions for current payments to charity and deductions for amounts "permanently set aside" for later payment.

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

The House and Senate Reports on the 1954 Code (H.R. 8300) each explain the exclusion of § 642(c) amounts from §§ 661 and 662 with reference to the "additional" deduction which the entity would be able to claim if not for this provision, suggesting that § 663(a)(2) is meant simply as an anti-duplication measure, not that there is an underlying policy of § 642(c) exclusivity. The American Bar Association's submission regarding the bill also supports the adoption of this provision as preventing an "additional" deduction for distributions for which a deduction would already be allowed under proposed § 642(c). See Senate Finance Comm. Hearings on H.R. 8300, 83d Cong., 2d Sess. 438.
However, the example in the Senate Report demonstrating the application of §§ 661-663 (S. Rep. 1622 at 351-353) suggests the opposite interpretation. The terms of a testamentary trust require that half of the trust income be distributed currently to the grantor's wife for life. The remaining half in the trustee's discretion may either be paid to the grantor's daughter, paid to designated charities, or accumulated. At the wife's death, the entire trust principal will be payable to the daughter. In the given year, the trust income consisted of dividends, rentals, and tax-exempt interest, of which the trustee distributed half to the wife and one-quarter each to the daughter and a charity. In determining the § 661(a) distribution deduction, the example excludes the amount distributed to the charity since it was allowed as a deduction under § 642(c) to the extent that it was included in the trust's gross income. However, the entire amount paid to the charity is not deductible under § 642(c) because a ratable part of it is attributable to the tax-exempt interest which does not enter into gross income and thus fails one prong of the § 642(c) test. The example does not add the disallowed portion of the charitable payment back into § 661 for determining the distribution deduction, thus indicating that payments to charity are deductible, if at all, only under § 642(c). The example in the Senate Report was substantially adopted as the example illustrating §§ 661-662 in § 1.662(c)-4. That section and § 1.663(a)-2 were both published as part of the original subchapter J regulations, T.D.6217 (12/19/56). The latter originally only referred to limits on charitable deductions under § 681, and was later amended to include the limits under §§ 508(d) and 4948(c)(4) added by the 1969 Act.

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

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

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

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

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

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

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

As an initial matter, the IRS asserts, and the Trust agrees, that the statutory phrase “any amount of the gross income” means that charitable donations must be made out of a trust’s gross income, but that real property purchased with gross income can also be treated as the equivalent of gross income for purposes of the deduction outlined in § 642(c)(1). This, we conclude, is an entirely reasonable interpretation of the statutory language. More specifically, this interpretation is consistent with the statutory language, and also encourages charitable donations to a greater degree than an interpretation that fails to include a sourcing component, i.e., an interpretation that limits the deduction to donations made exclusively from gross income.4 See Old Colony, 301 U.S. at 384 (“Congress sought to encourage donations out of gross income . . . .”).

That still leaves open the question of the allowable amount of a deduction for donated real property that was purchased with a taxpayer’s gross income. The IRS has consistently asserted, both in addressing the Trust’s claim for a refund and in this litigation, that the deduction amount is limited to the taxpayer’s
adjusted basis in the donated real property, i.e., the amount of gross income the taxpayer originally paid for the real property. Without granting any deference to the IRS’s position, we conclude that it is the most reasonable interpretation of the statutory language, particularly when considered in light of the Code as a whole.

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As the IRS correctly notes in this case, because the Trust never sold or exchanged the properties at issue, it never realized the gains associated with their increases in market value and was therefore never subject to being taxed on those gains. Thus, construing § 642(c)(1)’s deduction to extend to unrealized gains would be inconsistent with the Code’s general treatment of gross income. Consequently, unless and until Congress acts to make clear that it intended for the § 642(c)(1) deduction to extend to unrealized gains associated with real property originally purchased with gross income (similar to what Congress did in § 170, which, as we have noted, addresses charitable contributions by individuals and corporations), we conclude that we cannot construe the deduction in that manner.

Finally, we note that this interpretation finds support in a leading tax treatise, see 9 MERTENS LAW OF FEDERAL INCOME TAXATION, § 36:75 (Eric D. Roth ed., Dec. 2017) (“Where appreciated property purchased from accumulated gross income is donated, the amount of the deduction is limited to the adjusted basis of the property, rather than based on the fair market value of the donated property.”), as well as, at least in part, an older Third Circuit case dealing with § 642(c)(1)’s predecessor statute. See W. K. Frank Trust of 1931 v. Comm’r, 145 F.2d 411, 413 (3d Cir. 1944) (holding that the appreciated value of shares of donated stock, which was the result of them being “worth more on the market when the gift was made than . . . when the trust got them,” “was not gross income”).

2. Estate Tax Deduction Reduced Because of Post-Mortem Manipulation. In Estate of Victoria E. Dieringer et al. v. Commissioner, 146 T.C. No. 8 (2016), the decedent left a controlling interest, and a majority of the equity, in a real estate C corp (DPI) to a family foundation. After death, and before distribution to the foundation, the corporation redeemed the voting interests and a significant portion of the equity. Because the decedent owned the control, the non-voting interests were valued with a 5% discount in her estate, but with discounts of 15% for lack of control and 35% for lack of marketability in the redemption. A rationale for the redemption was the desire of the corporation to elect S status, and to avoid the problems of foundation ownership. Yet the foundation received less than the Form 706 value. The Tax Court held that the value of the charitable deduction would be limited to the value actually received by the foundation. The Ninth Circuit has agreed. Dieringer v. Commissioner of Internal Revenue, 917 F.3d 135 (9th Cir. 2019). The opinion states:

We affirm in light of our holding in Ahmanson Foundation v. United States, where we underscored “the principle that the testator may only be allowed a deduction for estate tax purposes for what is actually received by the charity.” 674 F.2d 761, 772 (9th Cir. 1981). We also affirm the Tax Court's ruling sustaining an accuracy-related penalty under I.R.C. § 6662.

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At the center of the parties' dispute is whether the Estate's charitable deduction should be valued at the time of Victoria's death, or whether the post-death events that decreased value of the property delivered to charity should be considered.

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Deductions are valued separately from the valuation of the gross estate. See Ahmanson, 674 F.2d at 772 (“The statute does not ordain equal valuation as between an item in the gross estate and the same item under the charitable deduction.”). Separate valuations allow for the consideration of post-death events, as required by Ahmanson and provisions of the tax code.

We addressed valuation of a charitable deduction in Ahmanson. There, the decedent's estate plan provided for the voting shares in a corporation to be left to family members and the nonvoting shares to be left to a charitable foundation. Id. at 765–66. We held that when valuing the charitable deduction for the nonvoting shares, a discount should be applied to account for the fact that the shares donated to charity had been stripped of their voting power. Id. at 772. That a discount was not applied to the value of the nonvoting shares in the gross estate did not impact our holding. Id. Importantly, we recognized that a charitable deduction “is subject to the principle that the testator may only be allowed a deduction for estate tax purposes for what is actually received by the charity.” Id.

In contrast, the Estate argues the charitable deduction must be valued as of the date of Victoria's death, in keeping with the date-of-death valuation of an estate. We disagree. Although the Supreme Court and our court have applied that valuation method where the remainder of an estate is donated to charity after a post-death contingency, there is no uniform rule for all circumstances. Ithaca Trust, 279 U.S. at 154, 49 S.Ct. 291; Wells Fargo Bank & Union Tr. Co. v. Comm'r, 145 F.2d 132 (9th Cir. 1944). In Ithaca Trust, the decedent left the remainder of his estate to his wife for her life, with any assets remaining after her death to be donated to charity. 279 U.S. at 154, 49 S.Ct. 291. The decedent's wife unexpectedly died only six months after the decedent. Id. at 155, 49 S.Ct. 291. The Court considered whether the charitable deduction should reflect the amount actually given to charity after the wife's premature death, but ultimately determined that the deduction should instead reflect a valuation based on mortality tables for the wife on the date of the decedent's death. Id.

We applied Ithaca Trust in Wells Fargo, where the decedent had created a trust with instructions that the trust's income be paid to the decedent's sister from the date of the decedent's death to the date of the sister's death, and after the sister's death that the corpus of the trust be given to charity. 145 F.2d at 133. Due to commingling of assets after the decedent's death and an unrelated tax dispute, part of the corpus of the trust was used to support the decedent's sister, which reduced the amount that went to charity upon her death. Id. The Tax Court relied on these payments to disallow part of the charitable deduction, but we reversed, concluding that the charitable deduction must be determined from data available at the time of death. Id.; see also Estate of Van Horne v. Comm'r, 720 F.2d 1114, 1117 (9th Cir. 1983) (relying on Ithaca Trust to “hold that legally enforceable claims valued by reference to an actuarial table meet the test of certainty for estate tax purposes” when valuing spousal support obligation).

Neither Ithaca Trust nor Wells Fargo, however, set in stone the date of death as the date of the valuation of assets for purposes of a deduction. See Shedd's Estate v. Comm'r, 320 F.2d 638, 639 (9th Cir. 1963) (“Congress did not intend
to make events at the date of death invariably determinative in computing the federal estate tax obligation."). Nor could they. Certain deductions not only permit consideration of post-death events, but require them. For example, I.R.C. § 2053(a) authorizes a deduction for funeral expenses and estate administration expenses—costs that cannot accrue until after the death of the testator. Similarly, I.R.C. § 2055(c) specifies that where death taxes are payable out of a charitable bequest, any charitable deduction is limited to the value remaining in the estate after such post-death tax payment. Still another provision of the tax code, I.R.C. § 2055(d), prohibits the amount of a charitable deduction from exceeding the value of transferred property included in a gross estate—but, by negative implication, permits such a deduction to be lower than the value of donated assets at the moment of death. The Third Circuit also recognized that valuations of the gross estate and a charitable deduction are separate and may differ. In Re Sage's Estate, 122 F.2d 480, 484 (3d Cir. 1941) (“[W]hile a decedent's gross estate is fixed as of the date of his death, deductions claimed in determining the net estate subject to tax may not be ascertainable or even accrue until the happening of events subsequent to death.”).

Indeed, “[t]he proper administration of the charitable deduction cannot ignore such differences in the value actually received by the charity.” Ahmanson, 674 F.2d at 772; accord Irving Tr. Co. v. United States, 221 F.2d 303, 306 (2d Cir. 1955); Thompson's Estate v. Comm'r, 123 F.2d 816, 817 (2d Cir. 1941); In Re Sage's Estate, 122 F.2d at 484. This rule prohibits crafting an estate plan or will so as to game the system and guarantee a charitable deduction that is larger than the amount actually given to charity. Ahmanson, 674 F.2d at 772.

The Court had harsh words for the decedent’s estate plan that put only one of the decedent’s twelve children in charge of everything:

Victoria structured her Estate so as not to donate her DPI shares directly to a charity, or even directly to the Foundation, but to the Trust. Victoria enabled Eugene to commit almost unchecked abuse of the Estate by setting him up to be executor of the Estate, trustee of the Trust, and trustee of the Foundation, in addition to his roles as president, director, and majority shareholder of DPI. As the Tax Court found, Eugene improperly directed Lewis Olds to determine the redemption value of the DPI shares by applying a minority interest valuation, when he knew a majority interest applied and the Estate had claimed a charitable deduction based upon a majority interest valuation. Through his actions, Eugene manipulated the charitable deduction so that the Foundation only received a fraction of the charitable deduction claimed by the Estate.

The Estate attempts to evade Ahmanson by arguing that it is limited to situations where the testamentary plan diminishes the value of the charitable property. Read in context, Ahmanson is not limited to abuses in the four corners of the testamentary plan. Id. Ahmanson extends to situations where “the testator would be able to produce an artificially low valuation by manipulat[ion],” which includes the present situation. Id. Moreover, Victoria's testamentary plan laid the groundwork for Eugene's manipulation by concentrating power in his hands—in his roles as executor of the Estate and trustee of the Trust and Foundation—even after she knew of and assented to early discussions of the share redemption plan.

Suppose there had been no trust. Would the Tax Court and Court of Appeals have reached a different decision? Suppose a different set of facts: Eugene redeemed the estate for date of death value and then stole $1
million from the estate. Would that have reduced the charitable deduction? Another approach to this case would have been to allow the estate tax charitable deduction and impose private foundation penalties on the foundation, and Eugene, for acquiescing in the receipt of less than was due. Uncorrected, that penalty would have been greater. The Ninth Circuit notes that the probate court has approved this transaction as not being self-dealing but presumably the IRS does not believe it is bound by such a holding.

Many transactions occur where a charity sells a remainder interest it owns for fair market value. When the predecessor interest terminates, the charity receives the asset but then transfers it to the previous purchaser. Those transactions are different from Dieringer because charity receives full value albeit earlier than the original gift contemplated.

3. **Receipt of Benefits Disqualifies Charitable Deduction**

   In *Wendell Falls Development, LLC v. Commissioner*, T.C. Memo. 2018-45, the court found that the taxpayer received benefits in connection with the grant of a conservation easement. The opinion states:

   That Wendell Falls expected a substantial benefit from the contribution of the easement is supported by the record. When it donated the easement, Wendell Falls owned land adjoining the eased property; i.e., the unencumbered portion of the 1,280 acres. On the unencumbered portion of the 1,280 acres, Wendell Falls planned to create a master-planned community, which was designed so that all of the clusters of residential areas would have access to the 125-acre park through a system of “greenways”. These plans were evidenced by the PUD approved by the town of Wendell. As the prospective seller of the residential lots in the clusters, Wendell Falls would benefit from the increased value to the lots from the park as an amenity. It is uncontested that the easement restricts the 125 acres to uses related to establishing a park. Ferguson, one of the two managing members of Wendell Falls, wrote in an email to Wake County that Wendell Falls “need[ed] to ensure that the County uses the park for its intended use.” This confirms that Wendell Falls expected to receive value from the park and intended the easement to ensure that there would be a park on the 125 acres.

   We therefore find that Wendell Falls donated the easement with the expectation of receiving a substantial benefit. A charitable-contribution deduction is not allowable because of this expectation.

   In *Triumph Mixed Use Investments III, LLC v. Commissioner*, T.C. Memo. 2018-65 a deduction was negated by the expectation that a development plan would be approved. The court stated:

   The tax matters partner argues that Triumph is entitled to a deduction because it transferred the 746.785 acres of real property and 1,958 development credits without consideration. The tax matters partner argues that the agreement for charitable contribution demonstrates that Triumph did not receive any consideration, or that even if Triumph did receive some consideration, it was incidental. We disagree. In exchange for transferring this property, Triumph received the city council’s approval of the concept plan and the expectation that the city council would approve the area plan.

   The transfer of real property and development credits was integral to the city council’s approval of both plans. The external features of the transaction
demonstrate that the real property and development credits were transferred in exchange for the concept plan approval. The Traverse entities desperately wanted to have their new area plan approved to allow them to develop the additional units received in the Cabela's deal. However, before the city council would approve the area plan, the Traverse entities needed to get a new concept plan approved.

When the Traverse entities submitted the new concept plan, they were met with public opposition and resistance from the Planning Commission. The obstacles that the Traverse entities needed to overcome were the demands for more open space and a reduction in density. The city council's solution was to require the Traverse entities to dedicate open space and reduce density before the concept plan was approved.

After receiving contingent approval, the Traverse entities finished the area plan; and the Planning Commission approved the Traverse entities' request for recommendation of area plan approval. Triumph subsequently executed the agreement for charitable contribution thus satisfying the city council's demand for more open space. At its next meeting the city council approved the 2012 area plan. Thus, the Traverse entities' entire course of dealing with the city of Lehi shows that Triumph transferred the real property and development credits as part of a negotiation in which the city of Lehi received open space and the Traverse entities received as a quid pro quo concept plan approval.

Triumph also transferred the real property and development credits with the expectation that the Traverse entities would receive an area plan approval. Because an area plan was required to closely follow the concept plan, the Traverse entities expected the city council to approve the area plan after satisfaction of the contingencies that they had negotiated for the concept plan. Indeed, the city council approved the area plan on the finding that the Traverse entities had satisfied the contingencies in the concept plan approval. Accordingly, we also find that the Traverse entities transferred the real property and development credits because they believed that this transfer would lead to the city council's approving their area plan.

[footnotes omitted]

4. Conservation Easement Controversy. The IRS is very grumpy with syndicated easements.

Notice 2017-10 states:

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

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

The effect of the Notice is retroactive:

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

Material advisors, including appraisers, who make a tax statement on or after January 1, 2010, with respect to transactions entered into on or after January 1, 2010, have disclosure and list maintenance obligations under §§6111 and 6112. See §§301.6111-3, 301.6112-1.

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

Acts to prevent the enforcement of Notice 2017-10 have been introduced. In Notice 2017-29, 2017-20 I.R.B. 1243 (May 15, 2017), the IRS stated that disclosures of participation in a syndicated conservation easement, required by Notice 2017-10, 2017-4 I.R.B. 544, will not be due until October 2, 2017, rather than June 21, 2017, as original announced, and clarified that donee-charities are not material advisors, for purposes of the disclosure rules. This was the subject of intense lobbying.


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

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

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

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

No cases or rulings appear to establish that a section 501(c)(4) organization would be a disqualified person. This may create a useful opportunity to use section 501(c)(4) organizations to avoid excess business holdings and self-dealing issues that could arise from transfers of closely-held business interests to a private foundation.
Section 4943 would preclude a private foundation from long-term ownership of more than 20 percent of the voting stock of a corporation or other business enterprise in combination with all disqualified persons. However, if a section 501(c)(4) organization is not a disqualified person, it could own a “business enterprise” with one or more private foundations in a manner that would avoid violating the prohibition against excess business holdings under section 4943. If an owner transferred interests in a closely-owned business to a private foundation in conjunction with a transfer to a section 501(c)(4) organization, it may be possible to avoid excess business holdings.

To illustrate,

- Donor could recapitalize her closely-held business enterprise from 1 million shares of common stock to 100,000 shares of voting stock and 900,000 shares of nonvoting stock.
- Donor then could contribute 80,000 shares of voting stock to a new section 501(c)(4) organization that Donor’s family controls, without incurring gift tax.
- At death, Donor could contribute 20 percent of voting stock and all nonvoting stock to a private foundation, and the section 501(c)(4) organization would own 80 percent of the voting stock.

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

- Purchase or borrow assets from a related private foundation.
- Lease real estate to a related private foundation.
- Co-own and co-invest with a related private foundation.

6. Another Indirect Self-Dealing Issue Avoided Via Non-Voting LLC Interests. A note between a disqualified person and a private foundation is an extension of credit and self-dealing. This limits the ability of notes from a sale to a grantor trust to be given or bequeathed to a private foundation. In recent years the IRS has allowed notes to be transferred to an LLC and non-voting units given to the foundation. That’s what happened in PLR 201723005. The ruling recites these facts:

Founder sold membership interests in First LLC to Irrevocable Trust in exchange for a promissory note. Founder’s descendants are beneficiaries of Irrevocable Trust. Founder desires that, following her death, any part of the principal and interest on the promissory note which remains then unpaid be used to benefit Foundation.

To that end, Founder contributed and transferred the promissory note to New LLC in exchange for voting and nonvoting interests, which subsequently were transferred to Revocable Trust. Founder is the settlor and sole trustee of
Revocable Trust and holds a revocation power in the form of a power to direct the trustee to distribute the assets of the trust to her during her lifetime. Founder’s descendants are beneficiaries of Revocable Trust.

New LLC will hold and administer the promissory note and receive payments of interest and principal on the promissory note. New LLC’s sole asset and source of income is, and will be, the promissory note.

Power to manage the affairs of New LLC is vested in the manager, who is selected and may be removed by the members holding voting interests in New LLC. One of Founder’s sons, who is also a director of Foundation, is the sole manager of New LLC. The members holding nonvoting interests possess no management rights or rights to vote on the manager of New LLC. New LLC may only be dissolved with written approval of all members, whether holding voting or nonvoting interests.

Founder proposes that at the time of her death, Revocable Trust (which will become irrevocable at that time) will distribute to Foundation all of the nonvoting interests in New LLC, which have a profit-sharing ratio of 99 percent. Revocable Trust will retain its voting interests in New LLC, which have a profit-sharing ratio of one percent.

The ruling concludes:

Irrevocable Trust and Revocable Trust are disqualified persons under section 4946(a)(1)(G) with respect to Foundation because they are trusts in which Founder’s descendants, who are disqualified persons under section 4946(a)(1)(D) with respect to Foundation, hold more than a 35-percent beneficial interest. Irrevocable Trust is the obligor of a promissory note that was held by Founder. Founder desires that, following her death, any unpaid principal and interest on the promissory note be used to benefit Foundation. An act of self-dealing would occur if Founder transferred the promissory note to Foundation, which would become creditor under the note. See Treas. Reg. §53.4941(d)-2(c).

Instead, Founder contributed and transferred her ownership of the promissory note to New LLC. At Founder’s death, Foundation will acquire the nonvoting interests in New LLC, which have a profit-sharing ratio of 99 percent, by gift through a distribution from Revocable Trust, rather than through a self-dealing transaction. If Foundation will “control” New LLC within the meaning of Treas. Reg. §53.4941(d)-1(b)(5), then Foundation will be indirectly serving as the creditor under the note by reason of its ownership interest. See Treas. Reg. §53.4941(d)-1(b)(8), Example (1). However, Foundation will not “control” New LLC within the meaning of Treas. Reg. §53.4941(d)-1(b)(5) due to lack of voting power.

As holder of the nonvoting interests, Foundation will have no management rights or right to vote on the manager of New LLC. Revocable Trust (which will have become irrevocable at Founder’s death) will own all of the voting interests, giving Revocable Trust the right to select and remove the manager of New LLC. As a holder of nonvoting interests, Foundation will have a right to receive distributions only if New LLC dissolves or chooses to make current distributions, but the timing and amount of such distributions will be uncertain and could not be compelled by Foundation. Only Revocable Trust as the holder of the voting interests may elect or remove the manager of New LLC, and such
manager will have the sole power to manage the affairs of New LLC and determine the timing and amount of distributions. Thus, Foundation and Foundation’s managers (acting only in such capacity) will not have sufficient votes or positions of authority to cause New LLC to engage in a transaction.

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

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

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

8. **Donor Advised Fund Guidance.** Notice 2017-73 deals with several long-time concerns of the IRS and Treasury. One is so-called bifurcated grants. Certain distributions from a donor-advised fund that pay for the purchase of tickets that enable a donor or donor advisor (or certain related persons under section 4958(f)(7)) to attend or participate in a charity-sponsored event would result in “more than incidental benefit” to the donor or donor advisor and thus give rise to an excise tax under section 4967. The Notice provides that this transaction may also result in an excess benefit transaction under section 4958. This issue is controversial. Many commentators and practitioners believe that a no grant should be allowed if any part of the transaction is non-charitable; others believe that if a charity – a DAF – pays the portion that would be deductible for income tax purposes then there is no abuse.

Certain distributions from a donor-advised fund that the recipient charity treats as fulfilling a pledge made by a donor or donor advisor (or certain related persons) would not result in a more than incidental benefit under section 4967, regardless of whether the recipient charity treats the distribution as satisfying the pledge and regardless of whether the pledge is enforceable under current law. A suggested requirement that the sponsoring organization make no reference to the existence of any individual’s pledge when making the distribution. Further, no donor or advisor may receive any other benefit that is more than incidental following the distribution has been criticized. The donor or advisor must not attempt to claim a charitable contribution deduction under Section 170 with respect to the distribution. These rules would not apply for purposes of determining whether this transaction gives rise to excise taxes for self-dealing under section 4941. The IRS specified that taxpayers could rely on these rules until additional guidance is issued.
Changes to the public support computation for publicly-supported charities described in sections 170(b)(1)(A)(vi), 509(a)(1) and 509(a)(2) would treat a sponsoring organization’s distribution from a donor-advised fund as coming from the donor (or donors) that funded the donor-advised fund rather than from the sponsoring organization. The new rules would also require a donee organization to treat all anonymous contributions (including a donor-advised fund distribution for which the sponsoring organization fails to identify the donor that funded the donor-advised fund) as being made by one person. Lastly, distributions from a sponsoring organization can be treated as public support without limitation if the sponsoring organization specifies that the distribution is not from a donor-advised fund or states that no donor or donor advisor advised the distribution. The issue here is the ability of a taxpayer to “launder” money through DAFs to avoid creating what would otherwise be a private foundation.

Treasury and the IRS requested comments regarding these issues and suggestions for future guidance with respect to donor-advised funds. The IRS has also requested guidance regarding whether a transfer of funds by a private foundation to a donor-advised fund should be treated as a “qualifying distribution” for purposes of section 4942. The argument in favor is that a DAF is just another public charity. The argument against is the concern that DAFs warehouse contributions.

9. Indirect Self-Dealing Inapplicable To QTIP While Spouse Is Living

In PLR 201831009, the key issue was whether a QTIP whose assets would pass to a private foundation at the surviving spouse’s death was subject to the self-dealing rules. Because no charitable deduction was taken, there was no self-dealing. The ruling states:

Upon Spouse’s death, all the assets of Trust will be includible in Spouse’s gross estate pursuant to section 2044 and deductible from Spouse’s taxable estate pursuant to section 2055. Subsequently, at such time as no non-charitable interests continue to exist and amounts have been deducted under section 2055 with respect to amounts held in Trust, Trust generally would become described as a noneexempt charitable trust under section 4947 (a)(1) and be subject to the provisions of sections 4941, 4943, 4944, and 4945.

However, the regulations under section 4947 provide that, in the case of a trust created by will, from which the trustee is required to distribute all the assets in trust for or free of trust to charitable beneficiaries, the restrictions imposed by section 4947(a)(1) do not apply for a reasonable period of settlement. Treas. Reg. §§ 53.4947-1(b)(2)(v). The term “reasonable period of settlement” means that period reasonably required (or, if shorter, actually required) by the trustee to perform the ordinary duties of administration necessary for the settlement of the trust. These duties include, for example, the collection of assets, the payment of debts, taxes, and distributions, and the determination of rights of the subsequent beneficiaries. Only after a reasonable period of settlement is a trust described in Treas. Reg. § 53.4947-1(b)(2)(v) considered a charitable trust under section 4947(a)(1).

We note, however, that during this reasonable period of settlement, transactions with respect to Foundation’s interest or expectancy in Trust may result in indirect self-dealing between Foundation and a disqualified person with respect to Foundation if the requirements of Treas. Reg. 53-4941-1(b)(3) are not met.
We are not ruling whether the proposed transaction will meet these requirements.

10. **Sprinkling Unitrust.** In PLR 201845014 the grantor created two charitable remainder trusts, identical except that the second was for the life of the grantor and the grantor’s spouse. The trustee had interesting sprinkling powers over the unitrust amount, described and approved by the IRS as follows:

In the present case, with respect to CRUT #1 and CRUT #2, Article 2.01(a)(2) provides that after providing for distribution of the minimum amount (the aggregate of amounts described in Article 2.01(a)(1)(A) and (B)) the trustee shall distribute the balance of the unitrust amount to such one or more of \( X \) and one or more charitable organizations (organization described in §§ 170(c), 2055(a) and 2522(a)) included in the charitable class as the independent trustee selects in the independent trustee's sole discretion without the approval or consent of any other person, and in such equal or unequal portions as the independent trustee determines in the independent trustee's sole discretion without the approval or consent of any other person.

As noted above, § 674(c) provides an exception to the general rule of § 674(a) with regard to certain powers to apportion trust income or principal among classes of beneficiaries. Thus, a provision that gives an independent trustee the power to allocate the unitrust amount among the charitable and noncharitable beneficiaries on an annual basis is not inconsistent with the provisions of the Code and regulations governing charitable remainder trusts, provided that the governing instrument requires that a portion of the unitrust amount must be allocated and paid to the noncharitable beneficiaries each year and provided that the portion of the unitrust amount so paid is not de minimis under the facts and circumstances for each year.

Based on the foregoing, and based solely on the information submitted and representations made, we conclude that the provisions in CRUT #1 and CRUT #2 that give the independent trustee the power to allocate a portion of the unitrust amount between noncharitable and charitable beneficiaries will not prevent CRUT #1 or CRUT #2 from qualifying as a CRUT under § 664(d)(2).

As noted, the trustee had to distribute some minimum, but unspecified, amount to a non-charitable beneficiary, the grantor. The grantor could designate the charitable beneficiaries prior to the payment date set in the trusts.

The IRS also confirmed that the grantor’s gift was complete when amounts were distributed. The ruling states:

In Rev. Rul. 77-275, 1977-2 C.B. 346, the settlor created a trust that provided for the distribution of the annual income therefrom to charitable organizations described in §§ 170(c) and 2522. Settlor reserved the power to designate the charitable organizations which would receive the income for the year. If the settlor did not make the designation prior to the beginning of the year, the trustee was empowered to select the charitable organizations at the end of the year and distribute the year's income to the selected organizations. The trust provided for reversion of principal to the settlor or the settlor's estate after ten years and one month. The revenue ruling concludes that the gift of the income interest is incomplete upon creation of the trust, in view of § 25.2511-2(c).
Further, although a completed gift of future income results from the settlor's exercise or lapse of his beneficial power of designation, no deduction is allowable for the present value of the interest since the trust is not in the form required under § 2522(c)(2). The revenue ruling states that if the trust had provided for the settlor's designation to be made after the end of the year in which the income was earned, the gift occurring by reason of such designation, or by the lapse of the right to designate, would be a gift of money, separate from the trust property itself, and thus a deduction would be allowable under § 2522.

In the present case, the situation is similar to that in Rev. Rul. 77-275, except that X's designation power here extends until the time income is actually distributed to the charitable organizations on the payment date. Prior to actual distribution, X may revoke any previously-made designation of the charitable class and will retain the power to designate the charitable class until the payment date, when the power lapses. Therefore, during X's lifetime, a completed gift occurs when the distribution of the net unitrust amount is actually made to the charitable organizations, rather than upon the creation and funding of CRUT #1 or CRUT #2 or upon any designation of the charitable class by X. Pursuant to Rev. Rul. 77-275, a deduction is allowable under § 2522 for this gift of money, which is separate from the trust property itself.

Accordingly, based on the facts submitted and the representations made, we conclude that X's power to designate the charitable class will prevent completion of the gift of the net unitrust amount of CRUT #1 and the net unitrust amount of CRUT #2 during X's lifetime until such power lapses. Furthermore, upon the annual lapse of X's power to designate the charitable class during X's lifetime and to the extent each year the net unitrust amount is distributed to one or more charitable organizations within the meaning of Article 6.07(a) of each of CRUT #1 and CRUT #2, the distributions will be completed gifts and will qualify for the gift tax charitable deduction under § 2522(a).

Of course, in the second trust the spouse's interest qualified for the marital deduction:

Section 20.2056(b)-8(a)(1) provides, in part, that if the surviving spouse of the decedent is the only noncharitable beneficiary of a charitable remainder unitrust described in § 664, § 2056(b)(1) does not apply to the interest in the trust that is transferred to the surviving spouse. Thus, the value of the unitrust interest passing to the spouse qualifies for a marital deduction under § 2056(b)(8) and the value of the remainder interest qualifies for a charitable deduction under § 2055.

In the legislative history to the Economic Recovery Tax Act of 1981, the House Ways and Means Committee stated:

If an individual transfers property outright to charity, no transfer taxes generally are imposed. Similarly, under the unlimited marital deduction provided in the committee bill, no tax generally will be imposed on an outright gift to the decedent's spouse. As a result, the committee finds no justification for imposing transfer taxes on a transfer split between a spouse and a qualifying charity. Accordingly, the bill provides a special rule for transfers of interests in the same property to a spouse and a qualifying charity.

Under the bill, if an individual creates a qualified charitable remainder annuity trust or a qualified charitable remainder unitrust, and the only noncharitable beneficiaries are donor and his spouse, the disallowance rule for terminable
interests does not apply. Therefore, the individual will receive a charitable deduction (under § 2055 or 2522) for the amount of the remainder interest and a marital deduction (under § 2056 or 2523) for the value of the annuity or unitrust interest; no transfer tax will be imposed.


In this case, the entire value of CRUT #2 as of X's date of death will be includible in X's gross estate. If CRUT #2 satisfies the requirements of § 664, the value of the charitable remainder interest will qualify for a charitable deduction under § 2055(e)(2)(A) because the remainder interest is in a charitable remainder unitrust described in § 664. If CRUT #2 satisfies the requirements of § 664, the value of X's spouse's interest in the survivor unitrust interest qualifies for a marital deduction under § 2056(b)(8). However, in this case, the value of X's spouse's interest in the survivor unitrust interest for purposes of determining the deduction available pursuant to § 2056(b)(8) is unclear as only a portion of the unitrust amount (the minimum amount) is required to be paid to X's spouse's under the instrument, with a larger portion of the unitrust amount (the net unitrust amount) payable to either X's spouse or the charitable beneficiaries, a determination made after the death of X by the independent trustee, as the independent trustee may annually decide. In light of the legislative history noted above, we conclude that under these facts, where X's spouse is the only noncharitable beneficiary of the survivor unitrust interest, the estate tax marital deduction under § 2056(a) will completely offset the value of the assets of CRUT #2 included in the gross estate of X after deducting the value of the remainder interest of CRUT #2 qualifying for a charitable deduction under § 2055(a).

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

The opinion states:

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

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

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

2. 2005 Easement

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

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

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

Besides permitting the relocation of homesites, the easement permits Pine Mountain to build within the 2005 Conservation Area other structures and facilities appurtenant to the residential development. These include:
• at least ten barns, each of which may include “an apartment for occupancy by a caretaker and such caretaker’s family”;

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

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

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

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

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

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

We conclude that the rights reserved to Pine Mountain, considered in their entirety, prevent the 2005 easement from constituting a “qualified real property interest.” See sec. 170(h)(2). As in Bosque Canyon, the easement deed allows all ten residences to be moved from the man-made lake to other, possibly more desirable, locations within the 2005 Conservation Area. And as in Bosque Canyon, the easement places no limits on how many homesites can be moved, how often this can be done, or how far into the future such relocations can occur.

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

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

12. **IRS Approves Notes to CLAT via LLC.** In PLR 201907004 the IRS concluded there was no self-dealing on these facts:

Trustor transferred certain business interests to trusts established for the benefit of Trustor’s descendants (Beneficiary Trusts) in exchange for promissory notes that pay interest only for a term of 30 years, with the total principal amount due at the end of the term. The sole beneficiary or all of the beneficiaries of each Beneficiary Trust are Trustor’s descendants.

Trustor assigned the promissory notes to LLC, a State limited liability company. The members of LLC are Trustor, who holds all of the nonvoting interests in
LLC, and LLC 2, which holds all of the voting interests in LLC. The members of LLC 2 are Trustor's descendants and each holds interests as individuals.

LLC will hold and administer the promissory notes and receive payments of interest and principal on the promissory notes. Aside from the cash initially contributed by LLC 2 for the voting interests in LLC (which will fund LLC expenses), LLC's sole assets and source of income will be the promissory notes.

Power to manage the affairs of LLC is vested in the manager, who is selected and may be removed by a vote of the members holding at least a majority of the voting interests in LLC (currently LLC 2, which holds 100 percent of such voting interests). Daughter, who is also the trustee of Trust, is the initial manager of LLC. Daughter holds interests in LLC only in an individual capacity indirectly through her interests in LLC 2, not in her capacity as trustee of Trust.

The members holding nonvoting interests (currently Trustor, who holds 100 percent of such nonvoting interests) possess no management rights or rights to vote on who will be the manager of LLC. LLC may be dissolved only with written approval of all members, whether holding voting or nonvoting interests.

Trust is a charitable lead annuity trust (CLAT) within the meaning of Rev. Proc. 2007-45, the charitable interest in which is a right to a guaranteed annuity, distributed annually to a public charity that is described in section 501(c)(3). The remainder interests benefit Trustor's descendants. Trustor proposes to fund Trust by transferring Trustor's nonvoting interests in LLC to Trust. The annuity amount shall be paid from Trust's income, including distributions from LLC, and, to the extent income is insufficient.

The IRS explanation was as follows:

Beneficiary Trusts are disqualified persons under section 4946(a)(1)(G) with respect to Trust because they are trusts in which Trustor's descendants, who are disqualified persons under section 4946(a)(1)(D) with respect to Trust, hold more than a 35-percent beneficial interest. Beneficiary Trusts are the obligors of promissory notes given to Trustor in exchange for certain business interests. An act of self-dealing would occur if Trustor transferred the promissory notes to Trust, which would become creditor under the notes. See Treas. Reg. § 53.4941(d)-2(c)(1).

Instead, Trustor assigned the promissory notes to LLC and proposes to transfer nonvoting interests in LLC to Trust. Trust will acquire the nonvoting interests in LLC by gift rather than through a self-dealing transaction. However, if Trust would be considered to “control” LLC within the meaning of Treas. Reg. § 53.4941(d)-1(b)(5), then Trust would be considered to be the creditor, indirectly, under the note by reason of its ownership interest in LLC. See Treas. Reg. § 53.4941(d)-1(b)(8), Example (1).

As holder of the nonvoting interests, Trust will have no management rights or right to vote on the manager of LLC. LLC 2 will own all of the voting interests, giving LLC 2 the right to select and remove the manager LLC. As a holder of nonvoting interests, Trust will have a right to receive distributions only if LLC dissolves or chooses to make current distributions, but the timing and amount of such distributions will be uncertain and could not be compelled by Trust. Only LLC 2, as the holder of the voting interests, may elect or remove the manager of LLC, and such manager will have the sole power to manage the affairs of LLC.
and determine the timing and amount of distributions. Thus, Trust and Trust's trustees (acting only in such capacity) will not have sufficient votes or positions of authority to cause LLC to engage in a transaction.

Additionally, Trust will not have the power to compel dissolution of LLC since LLC may only be dissolved with written approval of all members, including LLC 2. The power associated with the nonvoting interests of LLC as a necessary party to vote on the liquidation of LLC is not considered equivalent to a “veto power” within the meaning of Treas. Reg. § 53.4941(d)-1(b)(5) because the power cannot be exercised over an action relevant to any potential act of self-dealing. Consequently, Trust will not “control” LLC within the meaning of Treas. Reg. § 53.4941(d)-1(b)(5)

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


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

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

The valuation of approximately $33 million derives from an appraisal conducted by Howard Gelbtuch of Greenwich Realty Advisors, dated September 2003. As required by Treasury regulations, RERI attached the Gelbtuch appraisal to its return. RERI also completed a Form 8283 for Noncash Charitable Contributions; however, RERI left blank the space for “Donor’s cost or adjusted basis.” It did not provide any explanation for the omission.

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After a four-day trial, the Tax Court issued a judgment sustaining both the IRS’s determination that RERI was not entitled to any charitable contribution deduction and its assessment of the 40% penalty. The Tax Court, however, did not base its decision upon the “lack of economic substance” theory advanced by the IRS; instead, it concluded that RERI had failed to substantiate the value of the donated property as required by Treasury regulations. 149 T.C. at 17. Nonetheless, on its way to affirming the penalty for a gross valuation
misstatement, the Tax Court found the SMI [“successor member interest”] was worth $3,462,886 on the date of the donation. The court also held RERI did not qualify for the “reasonable cause” exception to accuracy-related penalties. See IRC § 6664(c).

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The IRS urges this court to affirm the Tax Court on the alternative theory that substantial compliance with the regulation does not suffice, so that RERI’s failure to include the basis on Form 8283 was automatically fatal. RERI, for its part, does not dispute that it failed to supply its basis in the SMI and to provide an explanation for the omission. Instead, RERI maintains that the substantial compliance doctrine does apply here, and that providing its basis in the donated property is not necessary for compliance. It emphasizes that both the Second Circuit and the Tax Court have concluded the substantiation requirements can be satisfied by substantial compliance. See Scheidelman v. Comm’r, 682 F.3d 189, 199 (2d Cir. 2012); Bond, 100 T.C. at 40-41.

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The Tax Court formulated the test for substantial compliance as “whether the donor provided sufficient information to permit the Commissioner to evaluate the reported contributions, as intended by Congress.” 149 T.C. at 16 (quoting Smith v. Comm’r, 94 T.C.M. 574, 586 (2007), aff’d, 364 F. App’x 317 (9th Cir. 2009)). The IRS advocates a significantly more stringent test under which anything short of complete compliance is excused only if “(1) the taxpayer had a good excuse for failing to comply with the regulation and (2) the regulation’s requirement is unimportant, unclear, or confusingly stated in the regulations or statute.” The Fourth, Fifth, and Seventh Circuits have adopted this formulation of the substantial compliance standard, albeit for different provisions of the tax code. See Volvo Trucks of N. Am., Inc. v. United States, 367 F.3d 204, 210 (4th Cir. 2004); McAlpine v. Comm’r, 968 F.2d 459, 462 (5th Cir. 1992); Prussner v. United States, 896 F.2d 218, 224 (7th Cir. 1990).

We conclude that, even if a taxpayer can fulfill the requirements of § 1.170A-13 through substantial compliance, RERI failed substantially to comply because it did not disclose its basis in the donated property; accordingly, we assume but do not decide that substantial compliance suffices. As we read the Tax Court’s decision, a taxpayer must supply its basis (or an explanation for failing to do so) in order to “provide sufficient information to permit the Commissioner to evaluate the reported contributions, as intended by Congress.” 149 T.C. at 16. If that is correct, and we think it is despite RERI’s several arguments to the contrary, then we need not choose between the Tax Court’s standard for substantial compliance and the IRS’s more exacting one.

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

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

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

Recall that an accuracy-related penalty applies only to the “portion of the underpayment ... attributable to one or more gross valuation misstatements.” § 6662(h)(1). RERI’s second argument is that, even if it misstated the value of the donated property, its underpayment is not “attributable to” that misstatement within the meaning of the penalty statute because the Tax Court’s stated reason for disallowing the deduction — which resulted in the underpayment — was RERI’s failure properly to substantiate the donation per IRC § 170 and the associated regulations. This ground for the adjustment does not relate to a misstatement of the value of the contributed property. Subsequently, however, the Tax Court also determined the taxpayer misstated the value of the donated property. In these circumstances, is the underpayment fairly “attributable to” the valuation misstatement? Put another way, can an underpayment be attributable to two independent grounds for an adjustment?

Consistent with its own precedent, the Tax Court answered this question in the affirmative. 149 T.C. at 21 (citing AHG Invs., LLC v. Comm’r, 140 T.C. 73 (2013)). Because the proper interpretation of the phrase “attributable to” is a legal issue, we resolve the question de novo. See Byers, 740 F.3d at 675. For the reasons that follow, we agree with the Tax Court that an underpayment can be “attributable to” more than one cause if one of the causes is a misstatement of value.

To begin, nowhere does the statute suggest there can be only a single cause for an underpayment. The phrase “attributable to” comfortably comprehends situations in which the IRS has multiple reasons for adjusting a charitable deduction. Moreover, as the First Circuit has recognized, RERI’s reading of § 6662 has the perverse result of “allow[ing] the taxpayer to avoid a penalty otherwise applicable to his conduct on the ground that the taxpayer had also engaged in additional violations that would support disallowance of the claimed losses.” Fidelity Int’l Currency Advisor A Fund, LLC v. United States, 661 F.3d 667, 673 (2011). A penalty is meant to deter and punish abuse of the tax laws; those purposes would be frustrated if it were interpreted in such a way as to reward a taxpayer for committing multiple abuses. See id.

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

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

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

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

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

The Blue Book ... offers the unremarkable proposition that, when the IRS disallows two different deductions, but only one disallowance is based on a valuation misstatement, the valuation misstatement penalty should apply only to the deduction taken on the valuation misstatement, not the other deduction, which is unrelated to valuation misstatement. The court in *Todd* mistakenly applied that simple rule to a situation in which the same deduction is disallowed based on both valuation misstatement- and non-valuation-misstatement theories.

*Alpha I, L.P.*, 682 F.3d at 1029.

We note also that more recent Fifth and Ninth Circuit decisions retreat from *Todd* and *Gainer*. In *PBBM-Rose Hill, Ltd. v. Commissioner*, for instance, the Tax Court had denied PBBM’s charitable contribution deduction for failing to
meet the statutory requirements for “a qualified conservation easement.” 900 F.3d 193, 209 (5th Cir. 2018). The Fifth Circuit nonetheless affirmed the Tax Court’s imposition of a penalty for a gross valuation misstatement for having also misstated the value of the easement. Id. at 215; see also Keller v. Comm’r, 556 F.3d 1056, 1060-61 (9th Cir. 2009) (recognizing the approach we take here as “sensible,” but explaining that its decision is “constrained by Gainer”).

In sum, because the Tax Court determined that RERI made a gross valuation misstatement and that misstatement was an independent alternative ground for adjusting RERI’s deduction, the penalty properly applies.

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

14. Substantiation and Reporting Requirements for Cash and Noncash Charitable Contribution Deductions. On July 30, 2018, the IRS issued final regulations to provide guidance concerning substantiation and reporting requirements for cash and noncash charitable contributions. The final regulations reflect the enactment of provisions of the American Jobs Creation Act of 2004 and the Pension Protection Act of 2006. T.D. 9836, July 30, 2018 was the effective date. The existing regime was left largely undistributed. However, some changes – and interesting points – should be noted.

1. Contributions Made to a Distributing Organization. A donor who makes a charitable contribution to an organization that collects contributions and distributes them to ultimate recipient organizations (pursuant to the donor's instructions or otherwise) should treat as a donee for purposes of sections 170(f)(8) and 170(f)(17) an organization described in section 170(c) or a Principal Combined Fund Organization (PCFO) for purposes of the Combined Federal Campaign (CFC) and acting in that capacity.

2. Blank Pledge Card Is Not Substantiation. Section 170(f)(17) requires a taxpayer to maintain as a record of a contribution of a cash, check, or other monetary gift either a bank record or a written communication from the donee that shows the name of the donee organization, the date of the contribution, and the amount of the contribution. The proposed and final regulations at § 1.170A-15(b)(2) provide that a bank record includes a statement from a financial institution, an electronic fund transfer receipt, a canceled check, a scanned image of both sides of a canceled check obtained from a bank website, or a credit card statement. In addition, the proposed and final regulations provide that a written communication includes an email. Because a blank pledge card provided by the donee organization to a donor does not show the information required under section 170(f)(17), it is not sufficient substantiation for a cash, check, or other monetary gift.

3. Reasonable Cause Exception. In light of recent case law (see Crimi v. Commissioner, T.C. Memo. 2013-51), the paragraph relating to the reasonable cause exception set forth in Proposed Regulation § 1.170A-16(f)(6) has been deleted from the final regulations because it is inconsistent with the Tax Court's position. In Crimi, the IRS argued that there was no qualified appraisal. The Tax Court discussed the doctrine of substantial compliance with respect to the qualified appraisal regulation, but stated that it was unnecessary to decide whether it was applicable to the petitioners' case because they established that the failure was due to reasonable cause.
Specifically, the court stated that a reasonable cause inquiry is fact-intensive and facts and circumstances must be judged on a case-by-case basis. The court found that petitioners reasonably and in good faith relied on their long-time certified public accountant's advice that their appraisal met all the legal requirements to claim the deduction. Thus, the Final Regulations do not contain a standard for the reasonable cause exception.

4. Form 8283 Is Not a Contemporaneous Written Acknowledgment. Although no format is prescribed for a contemporaneous written acknowledgment (for example, an email may qualify), a contemporaneous written acknowledgment of a contribution by the donee organization must contain all of the information required by section 170(f)(8)(B). Moreover, section 170(f)(8)(A) states that the acknowledgment is made “by the donee organization.” Only Section B, part IV of Form 8283, completed for property valued at over $5,000, is a donee acknowledgment, and this acknowledgment only contains some of the information required by section 170(f)(8)(B). Accordingly, even a fully-completed Form 8283 does not satisfy the requirements of section 170(f)(8).

5. Partial interest. If the contributed property is a partial interest, the appraisal must be of the partial interest.

6. The Final Regulations carefully define who is a qualified appraiser as follows:

   (1) Qualified appraiser—(1) Definition. For purposes of section 170(f)(11) and § 1.170A-16(d)(1)(ii) and (e)(1)(ii), the term qualified appraiser means an individual with verifiable education and experience in valuing the type of property for which the appraisal is performed, as described in paragraphs (b)(2) through (4) of this section.

   (2) Education and experience in valuing the type of property—(i) In general. An individual is treated as having education and experience in valuing the type of property within the meaning of paragraph (b)(1) of this section if, as of the date the individual signs the appraisal, the individual has—

   (A) Successfully completed (for example, received a passing grade on a final examination) professional or college-level coursework, as described in paragraph (b)(2)(ii) of this section, in valuing the type of property, as described in paragraph (b)(3) of this section, and has two or more years of experience in valuing the type of property, as described in paragraph (b)(3) of this section; or

   (B) Earned a recognized appraiser designation, as described in paragraph (b)(2)(iii) of this section, for the type of property, as described in paragraph (b)(3) of this section.

   (i) Coursework must be obtained from an educational organization, generally recognized professional trade or appraiser organization, or employer educational program. For purposes of paragraph (b)(2)(i)(A) of this section, the coursework must be obtained from—

   (A) A professional or college-level educational organization described in section 170(b)(1)(A)(ii):
(B) A generally recognized professional trade or appraiser organization that regularly offers educational programs in valuing the type of property; or

(C) An employer as part of an employee apprenticeship or educational program substantially similar to the educational programs described in paragraphs (b)(2)(ii)(A) and (B) of this section.

(iii) Recognized appraiser designation defined. A recognized appraiser designation means a designation awarded by a generally recognized professional appraiser organization on the basis of demonstrated competency.

(3) Type of property defined—(i) In general. The type of property means the category of property customary in the appraisal field for an appraiser to value.

And certain individuals do not qualify; individuals who are not qualified appraisers. The following individuals are not qualified appraisers for the appraised property:

(i) An individual who receives a fee prohibited by paragraph (a)(9) of this section for the appraisal of the appraised property.

(ii) The donor of the property.

(iii) A party to the transaction in which the donor acquired the property (for example, the individual who sold, exchanged, or gave the property to the donor, or any individual who acted as an agent for the transferor or for the donor for the sale, exchange, or gift), unless the property is contributed within 2 months of the date of acquisition and its appraised value does not exceed its acquisition price.

(iv) The donee of the property.

(v) Any individual who is either—

(A) Related, within the meaning of section 267(b), to, or an employee of, an individual described in paragraph (b)(5)(ii), (iii), or (iv) of this section;

(B) Married to an individual described in paragraph (b)(5)(v)(A) of this section; or

(C) An independent contractor who is regularly used as an appraiser by any of the individuals described in paragraph (b)(5)(ii), (iii), or (iv) of this section, and who does not perform a majority of his or her appraisals for others during the taxable year.

(vi) An individual who is prohibited from practicing before the Internal Revenue Service by the Secretary under 31 U.S.C. 330(c) at any time during the three-year period ending on the date the appraisal is signed by the individual.
C. SECTION 408 — IRAs AND RETIREMENT PLANS

1. Retroactive Application of Beneficiary Designation Revocation Upon Divorce Statute

Upheld. In Sveen v. Melin, 138 S.Ct. 1815 (2018) the Supreme Court found that a Minnesota statute which automatically revoked a beneficiary designation upon divorce did not violate the contracts clause of the U.S. Constitution even when applied to designations prior to the statute’s enactment. The opinion sets the stage:

In 1997, Sveen and Melin wed. The next year, Sveen purchased a life insurance policy. He named Melin as the primary beneficiary, while designating his two children from a prior marriage, Ashley and Antone Sveen, as the contingent beneficiaries. The Sveen–Melin marriage ended in 2007. The divorce decree made no mention of the insurance policy. And Sveen took no action, then or later, to revise his beneficiary designations. In 2011, he passed away.

In this action, petitioners the Sveen children and respondent Melin make competing claims to the insurance proceeds. The Sveens contend that under Minnesota's revocation-on-divorce law, their father's divorce canceled Melin's beneficiary designation and left the two of them as the rightful recipients. Melin notes in reply that the Minnesota law did not yet exist when her former husband bought his insurance policy and named her as the primary beneficiary. And she argues that applying the later-enacted law to the policy would violate the Constitution's Contracts Clause, which prohibits any state “Law impairing the Obligation of Contracts.” Art. I, § 10, cl. 1.

Not all laws affecting pre-existing contracts are invalid. The Court has traditionally conjured up a test to decide which ones do and don’t as the opinion explains:

At the same time, not all laws affecting pre-existing contracts violate the Clause. See El Paso v. Simmons, 379 U.S. 497, 506–507, 85 S.Ct. 577, 13 L.Ed.2d 446 (1965). To determine when such a law crosses the constitutional line, this Court has long applied a two-step test. The threshold issue is whether the state law has “operated as a substantial impairment of a contractual relationship.” Allied Structural Steel Co., 438 U.S., at 244, 98 S.Ct. 2716. In answering that question, the Court has considered the extent to which the law undermines the contractual bargain, interferes with a party's reasonable expectations, and prevents the party from safeguarding or reinstating his rights. See id., at 246, 98 S.Ct. 2716; El Paso, 379 U.S., at 514–515, 85 S.Ct. 577; Texaco, Inc. v. Short, 454 U.S. 516, 531, 102 S.Ct. 781, 70 L.Ed.2d 738 (1982). If such factors show a substantial impairment, the inquiry turns to the means and ends of the legislation. In particular, the Court has asked whether the state law is drawn in an “appropriate” and “reasonable” way to advance “a significant and legitimate public purpose.” Energy Reserves Group, Inc. v. Kansas Power & Light Co., 459 U.S. 400, 411–412, 103 S.Ct. 697, 74 L.Ed.2d 569 (1983).

Here, the majority concludes:

Here, we may stop after step one because Minnesota's revocation-on-divorce statute does not substantially impair pre-existing contractual arrangements. True enough that in revoking a beneficiary designation, the law makes a significant change. As Melin says, the “whole point” of buying life insurance is to provide the proceeds to the named beneficiary. Brief for Respondent 16. But three aspects of Minnesota's law, taken together, defeat Melin's argument that the
change it effected “severely impaired” her ex-husband's contract. Ibid. First, the statute is designed to reflect a policyholder's intent—and so to support, rather than impair, the contractual scheme. Second, the law is unlikely to disturb any policyholder's expectations because it does no more than a divorce court could always have done. And third, the statute supplies a mere default rule, which the policyholder can undo in a moment. Indeed, Minnesota's revocation statute stacks up well against laws that this Court upheld against Contracts Clause challenges as far back as the early 1800s.

The majority believe that most ex-spouses do not want to benefit their former spouse, that doing so—changing a beneficiary designation upon divorce is “easy” to quote the opinion, so there is no real burden affecting the contract.

The Court's argument proceeds this way. Because people are inattentive to their life insurance beneficiary designations when they divorce, the legislature needs to change those designations retroactively to ensure they aren't misdirected. But because those same people are simultaneously attentive to beneficiary designations (not to mention the legislature's activity), they will surely undo the change if they don't like it. And even if that weren't true, it would hardly matter. People know existing divorce laws sometimes allow courts to reform insurance contracts. So people should know a legislature might enact new laws upending insurance contracts at divorce. For these reasons, a statute rewriting the most important term of a life insurance policy— who gets paid—somehow doesn’t “substantially impair” the contract. It just “makes a significant change.” Ante, at 7.

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

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

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

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

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

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

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

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

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

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

On Thursday, August 21, 2014, the sale of petitioner's former home closed. On the same day petitioner received a $524,981 Chase Bank cashier’s check, drawn from the closing, to redeposit the distribution back into the IRA. The check was made out to “PERSHING FBO NANCY J. BURACK”.

Petitioner's financial adviser initially advised her that she could deposit the check into the Pershing account at Bank of New York on Wall Street. But petitioner credibly testified that Capital Guardian later assured her that she could redeposit the distribution into her IRA by overnighting the check to Capital Guardian in North Carolina. On Thursday, August 21, 2014, petitioner overnighted the check to Capital Guardian. The check arrived at Capital Guardian on Friday, August 22, which was 58 days after petitioner received the IRA distribution.
On August 26, 2014, 62 days after petitioner received the IRA distribution, the check was deposited at Pershing into petitioner's IRA account ending in 0946. Both the deposit and the receipt of funds are reflected on the August 2014 Capital Guardian IRA statement. What happened between Capital Guardian's receipt of the check and the deposit at Pershing is not entirely clear.

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

In Wood v. Commissioner, 93 T.C. 114 (1989), a taxpayer transferred stock to Merrill Lynch before the expiration of the 60-day rollover period with the instruction that the shares be deposited into his IRA account. But Merrill Lynch's records showed that the shares were deposited into a nonqualified account and rolled over into the IRA after the expiration of the 60-day rollover period. Id. at 117.

In deciding whether the transaction qualified for rollover treatment, we looked at the substance of the transaction and the relationship between the taxpayer and Merrill Lynch. Id. at 120-121. We explained that where book entries conflict with the facts, the facts control. Id. at 121. We found that the transaction was entitled to rollover treatment because Merrill Lynch “had accepted petitioner's Sears stock for deposit to the IRA rollover account and held the stock subject to the IRA trust instrument.” Id. We found that Merrill Lynch's failure to record the transfer within 60 days was a bookkeeping error.

While not identical to the present case, Wood is applicable. The substance of the transaction and the relationship between petitioner and Capital [*7] Guardian/Pershing show that the late deposit is attributable to a bookkeeping error. Petitioner never communicated with Pershing about her account. All communication was with Capital Guardian. All of the account statements in the record were generated by Capital Guardian. Petitioner credibly testified that Capital Guardian assured her she could roll over the distribution by overnighting the check to Capital Guardian. It is undisputed that Capital Guardian received the check 58 days after petitioner received the distribution, but the transaction was not recorded by Capital Guardian until 62 days after petitioner received the distribution.

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

Rev. Proc. 2003-16, 2003-1 C.B. 359, provides guidance about hardship waivers under section 408(d)(3)(I). It states that an automatic hardship waiver “is granted only: (1) if the funds are deposited into an eligible retirement plan within 1 year from the beginning of the 60-day rollover period; and (2) if the financial institution had deposited the funds as instructed, it would have been a valid rollover.” Rev. Proc. 2003-16, sec. 3.03, 2003-1 C.B. at 360.

In this case the funds were deposited into petitioner's IRA within one year. And petitioner credibly testified that Capital Guardian assured her that the rollover could be completed by overnighting the check to Capital Guardian. Capital Guardian received the rollover check on August 22, 2014, 58 days after petitioner received the distribution. As discussed above, Capital Guardian was an appropriate institution for petitioner to send the check to. See supra p. 7. Had Capital Guardian deposited the check as instructed, there would have been a valid rollover. Therefore, petitioner is eligible for the automatic hardship waiver.

D. SECTIONS 671-678 -- GRANTOR TRUST RULES

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

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

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

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

Another potential power would be to require the grantor's consent before distributions were made to others. This power would pass muster in many of the asset protection states, including Delaware.
In IR-2007-127 (July 9, 2007) the IRS announced it was reconsidering its position on the gift tax consequences to the beneficiaries on the distribution committees. The IRS was likely spooked by comments from a professional group about the tax consequences of DINGs and the government's arguably incoherent ruling position. However, without comment on what learning has been achieved, the IRS began issuing rulings in this area, in March 2013.

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

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

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

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

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

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

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

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

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

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

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

If the Committee ceases to exist, the Trustee has the power to distribute net income to a beneficiary. However, the Trustee's power is not a condition precedent to each Grantor's Consent Power. Each Grantor's Consent Power over income is presently exercisable and not subject to a condition precedent. Thus, the Trustee's power to distribute net income does not cause the transfer of property to be complete with respect to the income interest in Trust for federal gift tax purposes. Therefore, each Grantor is considered as possessing the power to distribute income to any beneficiary himself or herself because he or she retained the Grantor's Consent Power.
Grantor also retained the Grantor's Sole Power over the principal of Trust. Under § 25.2511-2(c), a gift is incomplete if and to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves unless the power is a fiduciary power limited by a fixed or ascertainable standard. In this case, the Grantor's Sole Power gives Grantor the power to change the interests of the beneficiaries. Even though Grantor's power is limited by an ascertainable standard, i.e., health, education, and support, Grantor's power is not a fiduciary power. Accordingly, the retention of the Grantor's Consent Power and the Grantor's Sole Power causes the transfer of property to Trust to be incomplete for federal gift tax purposes.

If the Committee ceases to exist, the Trustee, in its fiduciary capacity, also has the power to distribute principal to one or more beneficiaries. The powers of the Trustee are not conditions precedent to the Grantor's powers. Grantor's Sole Power over principal is presently exercisable and not subject to a condition precedent. Accordingly, Grantor retains dominion and control over the principal of Trust until the Trustee exercises his or her power to appoint principal. See Goldstein v. Commissioner, 37 T.C. 897 (1962). Thus, the Trustee's powers to distribute principal do not cause the transfer of property to be complete with respect to the remainder in Trust for federal gift tax purposes. Accordingly, the retention of Grantor's Consent Power and Grantor's Sole Power causes the transfer of property to Trust to be wholly incomplete for federal gift tax purposes.

Further, Grantor retained the Grantor's Testamentary Power to appoint the property in Trust to any persons, other than to the Grantor's estate, Grantor's creditors, or the creditors of Grantor's estate. Under § 25.2511-2(b), the retention of a testamentary power to appoint the remainder of a trust is considered a retention of dominion and control over the remainder. Accordingly, the retention of this power causes the transfer of property to Trust to be incomplete with respect to the remainder for federal tax purposes.

Finally, the Committee members possess the Unanimous Member Power over net income and principal. This power is not a condition precedent to Grantor's powers. Grantor's powers over the net income and principal are presently exercisable and not subject to a condition precedent. Grantor retains dominion and control over the net income and principal of Trust until the Committee members exercise their Unanimous Member Power. Accordingly, the Unanimous Member Power does not cause the transfer of property to be complete with respect to the income interest for federal gift tax purposes. See Goldstein v. Commissioner, 37 T.C. 897 (1962); Estate of Goelet v. Commissioner, 51 T.C. 352 (1968).

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

A distribution from the trust to other than the grantor would be a gift by the grantor.

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

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

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

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

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

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

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

Under Article III(B), the initial members of the Distribution Committee are Independent Trustee, Individual A and Individual B. Article III(C) provides that Settlor, or if Settlor at any time is not able to act, the members of the Distribution Committee may appoint successor members to the committee. The Independent Trust also has the power under Article III(D) to appoint members to the committee.
Article III(F) provides that (i) there shall be at least one member of the Distribution Committee in office at all times during Settlor's life and (ii) a majority of the members of the committee shall, at all times during Settlor's life, consist of Eligible Beneficiaries.

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

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

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

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

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

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

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

In Virginian Hotel Corp. v. Helvering, 319 U.S. 523 (1943), the Supreme Court held that “allowed” meant that the taxpayer had taken the deduction and the Commissioner had not challenged it. Id. at 527. Noting that there was “no machinery for formal allowances of deductions from gross income,” a deduction being claimed and going unchallenged is the only way in which a deduction could be “allowed.”
Trust has both charitable and non-charitable beneficiaries and is not exempt from tax under § 501(a). One of the requirements to qualify as a split-interest trust described in § 4947(a)(2) is that the trust has amounts in trust for which a charitable deduction was allowed to some person (including the trust itself for a charitable set-aside). Settlor has represented that, for the duration of Trust, Trust will not hold any amounts for which a person claimed a charitable deduction for a transfer to Trust, or for which Trust claimed a charitable deduction under § 642(c)(2) for a set-aside. Thus, for Settlor’s life, Trust will not qualify as a split-interest trust under § 4947(a)(2). The fact that Settlor may claim a gift tax deduction under § 2522 (or that Trust may claim an income tax deduction under § 642(c)(2) when a charitable distribution from Trust is made is not material, because such amount is not held in Trust when the charitable deduction arises.

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

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

*Original Trust* was established by *Decedent* on *Date 1*. *Decedent* died on *Date 3*.

On *Date 2*, *Court* ratified the division of *Original Trust* into separate trusts for the benefit of each child of *Decedent*, and his or her spouse and issue. *Trust 1* resulted from this division.

The governing document for *Trust 1* (*Trust 1 Agreement*) authorizes *Trustee*, at any time, to distribute all or any portion of the net income or principal or both of *Trust 1* directly to any one or more of the *Beneficiaries* living at the time of such distribution or to the trustees of any trust of which such *Beneficiary* is a beneficiary.

Pursuant to the authority granted to the *Trustee* under the *Trust 1 Agreement*, the *Trustee* proposes to transfer funds from *Trust 1* to *Trust 2* which also benefits *Beneficiaries*. *Beneficiaries* rights to distributions under the *Trust 2* agreement are the same as those under the *Trust 1 Agreement*.

The governing document of *Trust 2* (*Trust 2 Agreement*) provides that *Trust 1* retains the power, solely exercisable by *Trust 1*, to revest the net income of *Trust 2* in *Trust 1*; provided, however, that such power shall lapse on the last day of such calendar year.

The *Trust 2* agreement provides that income includes (i) any dividends, interest, fees and other amounts characterized as income under § 643(b) of the Code, (ii) any net capital gains realized with respect to assets held less than twelve months, and (iii) any net capital gains realized with respect to assets held longer than twelve months.

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

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

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

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

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

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

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

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

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

[emphasis added]

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

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

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

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

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

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

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

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

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

**(a)** When a grantor or another person is treated under subpart E (section 671 and following) as the owner of any portion of a trust, there are included in computing his tax liability those items of income, deduction, and credit against tax attributable to or included in that portion. For example:

1. If a grantor or another person is treated as the owner of an entire trust (corpus as well as ordinary income), he takes into account in computing his income tax liability all items of income, deduction, and credit (including capital gains and losses) to which he would have been entitled had the trust not been in existence during the period he is treated as owner.

2. If the portion treated as owned consists of specific trust property and its income, all items directly related to that property are attributable to the portion. Items directly related to trust property not included in the portion treated as owned by the grantor or other person are governed by the provisions of subparts A through D (section 641 and following), part I, subchapter J, chapter 1 of the Code. Items that relate both to the portion treated as owned by the grantor and to the balance of the trust must be apportioned in a manner that is reasonable in the light of all the circumstances of each case, including the terms of the governing instrument, local law, and the practice of the trustee if it is reasonable and consistent.

3. If the portion of a trust treated as owned by a grantor or another person consists of an undivided fractional interest in the trust, or of an interest represented by a dollar amount, a pro rata share of each item of income, deduction, and credit is normally allocated to the portion.
Thus, where the portion owned consists of an interest in or a right to an amount of corpus only, a fraction of each item (including items allocated to corpus, such as capital gains) is attributed to the portion. The numerator of this fraction is the amount which is subject to the control of the grantor or other person and the denominator is normally the fair market value of the trust corpus at the beginning of the taxable year in question. The share not treated as owned by the grantor or other person is governed by the provisions of subparts A through D. See the last three sentences of paragraph (c) of this section for the principles applicable if the portion treated as owned consists of an interest in part of the ordinary income in contrast to an interest in corpus alone.

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

(1) Only ordinary income is included by reason of an interest in or a power over ordinary income alone. Thus, if a grantor is treated under section 673 as an owner by reason of a reversionary interest in ordinary income only, items of income allocable to corpus will not be included in the portion he is treated as owning. Similarly, if a grantor or another person is treated under sections 674-678 as an owner of a portion by reason of a power over ordinary income only, items of income allocable to corpus are not included in that portion. (See paragraph (c) of this section to determine the treatment of deductions and credits when only ordinary income is included in the portion.)

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

(3) Both ordinary income and other income allocable to corpus are included by reason of an interest in or a power over both ordinary income and corpus, or an interest in or a power over corpus alone which does not come within the provisions of subparagraph (2) of this paragraph. For example, if a grantor is treated under section 673 as the owner of a portion of a trust by reason of a reversionary interest in corpus, both ordinary income and other income allocable to corpus are included in the portion. Further, a grantor includes both ordinary income and other income allocable to corpus in the portion he is treated as owning if he is treated under section 674 or 676 as an owner because
of a power over corpus which can affect income received within a
period such that he would be treated as an owner under section 673 if
the power were a reversionary interest. Similarly, a grantor or another
person includes both ordinary income and other income allocable to
corpus in the portion he is treated as owning if he is treated as an owner
under section 675 or 678 because of a power over corpus.

(c) If only income allocable to corpus is included in computing a grantor's tax
liability, he will take into account in that computation only those items of
income, deductions, and credit which would not be included under subparts A
through D in the computation of the tax liability of the current income
beneficiaries if all distributable net income had actually been distributed to those
beneficiaries. On the other hand, if the grantor or another person is treated as an
owner solely because of his interest in or power over ordinary income alone, he
will take into account in computing his tax liability those items which would be
included in computing the tax liability of a current income beneficiary, including
expenses allocable to corpus which enter into the computation of distributable
net income. If the grantor or other person is treated as an owner because of his
power over or right to a dollar amount of ordinary income, he will first take into
account a portion of those items of income and expense entering into the
computation of ordinary income under the trust instrument or local law
sufficient to produce income of the dollar amount required. There will then be
attributable to him a pro rata portion of other items entering into the
computation of distributable net income under subparts A through D, such as
expenses allocable to corpus, and a pro rata portion of credits of the trust. For
examples of computations under this paragraph, see paragraph (g) of § 1.677(a)-
1.

4. **Trust Reformation To Create A Grantor Trust Consistent With Donor Intent.**  PLR
201807001 involved interesting facts. Between September 19, 1995 and August 20, 1996, Donor established a trust
which he intended to qualify as a grantor trust. The Trust permitted distributions to Donor and the issue of Donor
during Donor’s life. In addition, the trust agreement authorized the Independent Trustees, with approval of a court
of competent jurisdiction, to reform any provisions of the trust agreement so that burdensome tax consequences
may, consistent with the purpose of the Trust and trust agreement, be eliminated or minimized. Donor, Donor’s
spouse and Donor’s issue were not, and had never been, citizens or residents of the United States.

Section 672(f)(1) generally provides that the grantor trust provisions apply only to the extent such
application results in an amount, if any, being currently taken into account in computing the income of a citizen or
resident of the U.S. or a domestic corporation. Section 672(f)(2)(A)(ii), however, provides that the general rule of
section 672(f)(1) does not apply to any portion of a trust if the only amounts distributable during the lifetime of the
grantor are amounts distributable to the grantor or grantor’s spouse.

Section 672(f)(1) was effective on the date of enactment, August 20, 1996, but grandfather rules were
provided for certain trusts that were in existence on September 19, 1995, to the extent any transfers to such trusts
were made on or before that date. Accordingly, Donor was treated as the owner of any portion of the Trust over
which Donor retained the powers or interests described in sections 673 through 677 prior to August 20, 1996.
Donor was prevented from being the owner of the Trust by operation of section 672(f) as of August 20, 1996 and thereafter because Donor’s issue were beneficiaries of the Trust during Donor’s life.

Donor filed a suit to reform the Trust to satisfy the terms of section 672(f)(2)(A)(ii). Both Donor and the attorney who drafted the trust agreement testified regarding their intent for the Trust to qualify as a grantor trust. The court modified the trust agreement by removing “the issue of Donor” as beneficiaries during Donor’s lifetime. The court concluded that the original trust agreement was drafted based on what became a mistake of fact and law. Reforming the Trust to delete the inclusion of Donor’s issue as beneficiaries of the Trust during Donor’s lifetime would correct the mistake of fact and law and conform the trust agreement to Donor’s intent.

The IRS concluded that the reformation of the Trust was consistent with applicable state law that would be applied in the highest court of the state and, accordingly, that the Trust’s reformation would be taken into account as of the date of formation for the purpose of determining whether the Trust fell within the section 672(f)(2)(A)(ii) exception.

In Millstein v. Millstein, 2018 Ohio 2295 (Oh. App.), a grantor wanted reimbursement for income taxes due on the income of the grantor trust. The court refused. The UTC was of no help because it was the benefits to the grantor that were at issue.

5. **Grantor Trusts and Spouses**. PLR 2019-27003 is helpful. Each spouse created a grantor trust. Then spouse one sold a partnership interest to the other spouse’s trust, and Trust One sold interests to Trust Two. The ruling provides:

Section 1041(a)(1) of the Code provides that no gain or loss shall be recognized on a transfer of property from an individual to a spouse. Section 1041(b) of the Code provides that, in the case of any transfer described in subsection (a), (1) the property shall be treated as acquired by the transferee by gift, and (2) the basis of the transferee in the property shall be the adjusted basis of the transferor. Because Trust 1 is a grantor trust, assets sold by Trust 1 will be treated for federal tax purposes as sold by Spouse 1. In addition, because Trust 2 is a grantor trust, assets purchased from Taxpayer and Trust 1 will be treated for federal tax purposes as purchased by Spouse 2. Accordingly, based on the information submitted, we rule as follows: (1) Spouse 1 will recognize no gain or loss on the sale by Spouse 1 of a x percent limited partnership interest in Partnership to Trust 2 (§ 1041(a)(1) and Rev. Rul. 85-13). (2) Spouse 1 will recognize no gain or loss on the sale by Trust 1 of a x percent limited partnership interest in Partnership to Trust 2 (§ 1041(a)(1) and Rev. Rul. 85-13). (3) The basis of property acquired from Spouse 1 by Trust 2 will be the same as the adjusted basis in the property in the hands of Spouse 1 (§ 1041(b)(2)). (4) The basis of property acquired from Trust 1 by Trust 2 will be the same as the adjusted basis in the property in the hands of Trust 1 (§ 1041(b)(2)).
E. **SECTION 1361 – S CORPORATIONS**

F. **SECTIONS 2031 and 2512 – VALUATION**

1. **Paintings.** In Estate of Eva F. Kollsman v. Commissioner, TC Memo 2017-40, the issue was the value of two 17th Century Old Master paintings. The estate’s expert was George Wachter of Sotheby’s whose opinion was largely discounted by the court:

We find Mr. Wachter's valuations unreliable and unpersuasive for several reasons. First, he had a significant conflict of interest that could cause a reasonable person to question his objectivity. Mr. Wachter first gave his fair market value estimates for the paintings at the time of decedent's death (in amounts that remained unchanged in his expert report prepared for trial). His correspondence with Mr. Hyland [the executor] during that period demonstrates that the two had previously discussed the disposition of Maypole and Orpheus upon decedent's death and that Mr. Hyland was considering selling the paintings. Mr. Wachter provided his fair market value estimates at the same time he was soliciting Mr. Hyland for the exclusive rights for five years to auction the paintings in the event they were sold. Under Sotheby's terms at that time, an auction sale would have entitled Sotheby's to a 20% commission on the first $200,000 of the hammer price and 12% of the remainder. Thus, Mr. Wachter, on behalf of his firm, had a direct financial incentive to curry favor with Mr. Hyland by providing fair market value estimates that benefited his interests as the estate's residual beneficiary—that is to say, “lowball” estimates that would lessen the Federal estate tax burden borne by the estate. The fair market value estimate letter Mr. Wachter provided to Mr. Hyland was in fact used by him as the basis for the values reported on the estate tax return. The fact that Mr. Wachter simultaneously presented Mr. Hyland with these fair market value estimates and his pitch for exclusive auction rights for Sotheby's gives rise to an inference that the latter affected the former.

Second, on the basis of other substantial evidence in the record, we are convinced that Mr. Wachter exaggerated the dirtiness of the paintings on the valuation date and the risks involved in cleaning them. If cleaning the paintings presented the magnitude of risk postulated by Mr. Wachter, we find it inconceivable that he would not have raised these concerns with Mr. Hyland in the course of their discussions concerning auctioning the paintings. Yet Mr. Wachter did not recall any such discussion. Instead, Mr. Hyland made the decision to have the paintings cleaned because personnel at Lowy—a leading fine arts conservator—recommended cleaning and did not believe it posed any significant risk.

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Mr. Wachter attempts to account for the nearly fivefold increase in value between his $500,000 valuation in September 2005 and Maypole's $2,434,500 sale price in January 2009 by arguing that (1) the Lowy cleaning vastly improved the painting's condition and (2) there was a significant surge in the market demand for Old Master paintings after 2005.

We have rejected Mr. Wachter's claims regarding Maypole's precleaning condition as exaggerated. As for his claims regarding market demand, the estate introduced aggregate auction sales results demonstrating that 5 of the 10 highest sale totals for Old Masters auctions at Sotheby's and Christie's occurred after
2005 and included the January 2009 Sotheby's Old Masters auction. However, because these are only gross sales figures, they do not demonstrate the extent of appreciation in individual paintings, as the sales figures may reflect a larger volume of paintings sold rather than an increase in sale prices. Consequently, the aggregate sales volume figures fall considerably short of persuading us that either Brueghel paintings, or Old Master paintings generally, experienced a nearly fivefold increase in value between August 2005 and January 2009. Yet an appreciation rate of this magnitude would be necessary to reconcile Mr. Wachter's $500,000 valuation of Maypole with its sale at auction less than 3–1/2 years later for approximately $2,400,000. For this reason, we find that the January 2009 auction price casts doubt on Mr. Wachter's valuation. The lack of post–2005 market data in the record precludes any more definitive finding from Maypole's January 2009 sale price.

For the foregoing reasons, we give very little weight to Mr. Wachter's report and testimony regarding the fair market values of the Brueghel paintings on the valuation date.

The government’s expert, Paul Cardile, was more acceptable to the Court:

Mr. Cardile holds a Ph.D. from Yale University. He has taught college and graduate courses in art history at various institutions and served as museum director of the Denison Art Gallery in Granville, Ohio, from 1978 to 1984. Mr. Cardile is certified by the Appraisers Association of America and has appraised art for museums, private individuals, and corporations for the past 30 years.

His opinion was discussed by the Court as follows:

Mr. Cardile's report observes that Maypole's image is one of Pieter Brueghel's more popular motifs and is discussed in all the major works written about him. The report explains that the popularity of kermesse (i.e., festival) scenes such as Maypole caused Pieter Brueghel to produce multiple versions through his workshop, with differing degrees of involvement by Brueghel himself as opposed to workshop craftsmen. According to the report, the successful works would receive Pieter Brueghel's signature and sometimes the date.

Mr. Cardile's report contends that the quality and valuation of Pieter Brueghel's works largely turn on three factors: (1) the degree to which Pieter Brueghel's "hand"—that is, his direct intervention, correction, and supervision—is apparent in the work; (2) the condition of the work; and (3) the size of the work. The report notes that provenance (i.e., record of ownership) and citation in the literature are additional factors that may add to the value indicated by the first three.

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With respect to the comparables, Mr. Cardile's report opines that Maypole was closest in quality and condition to the Maypole-scene painting that sold for $3,330,272 in 1997. That Maypole-scene painting, according to Mr. Cardile, was considered by some to be the prototype for the others. Maypole (i.e., the painting at issue) exhibited the quality of the 1997–auctioned Maypole-scene painting because, Mr. Cardile opined, the facial characteristics in both were more lifelike, reflecting work by Pieter Brueghel himself rather than workshop craftsmen. Mr. Cardile found the Maypole-scene painting that sold for $538,560 in 1986 to be a poor comparable because it had been transferred from its original
support and was therefore in a compromised condition. Likewise, he thought the two Maypole-scene paintings that each sold for approximately $1 million in 1999 to be inferior artistically in that the facial features of the villagers were more caricature like, demonstrating a greater amount of workshop intervention than with Maypole.

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We accept that valuation with one qualification. On the basis of the entire record, we are satisfied that on the valuation date Maypole was quite dirty and needed to be cleaned by a conservator. We further accept that cleaning such a painting presented some degree of risk of damage for which a hypothetical willing buyer would insist on a discount. We are not persuaded of Mr. Wachter's description of the nature or degree of that risk, as it is incompatible with the routine manner in which Mr. Hyland, in consultation with a preeminent conservator, made the decision to clean the painting. Mr. Cardile made no adjustment for the dirty condition of Maypole on the valuation date, observing that "surface dirt do[es] not affect the intrinsic value of an Old Master Painting." In view of the conservators' assessment of the low risk of cleaning, we place the discount at 5%. Respondent has therefore shown, and we hold, that the fair market value of Maypole on the valuation date was 95% of Mr. Cardile's $2,100,000 valuation, or $1,995,000.

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Finally, while we found Mr. Cardile's report largely persuasive regarding Orpheus' attribution to Jan Brueghel the Elder, an attribution dispute nevertheless exists, rendering a discount appropriate. See Mathias v. Commissioner, 50 T.C. 994, 998 (1968); Doherty v. Commissioner, T.C. Memo. 1992–98, 63 T.C.M. (CCH) 2112, 2114–2115 (1992), aff'd, 16 F.3d 338 (9th Cir. 1994). Mr. Cardile valued Orpheus at $500,000 if attributed to Jan Brueghel the Elder and $325,000 if attributed to Jan Brueghel the Younger, an effective 35% discount for attribution to the lesser-regarded artist. Because Mr. Cardile has made a stronger case for attribution to Jan Brueghel the Elder, we weight the discount towards that attribution and limit it to 10%. Thus, applying a total discount of 25% off Mr. Cardile's $500,000 valuation premised on a Jan Brueghel the Elder attribution, respondent has met his burden of showing, and we hold, that Orpheus had a fair market value of $375,000 on the valuation date.

Arguably the taxpayer’s problem here was simply that a painting that sold in January 2009 for $2,434,500 “should not have had” an August 31, 2005 date of death value of $500,000 as the Maypole purportedly did per the taxpayer’s appraisal.

In a summary, unpublished opinion the Ninth Circuit affirmed the Tax Court. 2019 WL 2564084, 123 AFTR2d 2019-2296. The opinion states:

3. The Tax Court did not improperly base its valuation on Maypole’s sale price. Rather, in arriving at its valuation, the Tax Court primarily relied on Dr. Cardile’s valuation. Moreover, the Tax Court did not err in finding that Wachter failed to explain the nearly fivefold increase in value between his valuation and the sale price. Although Wachter asserted that there was a surge in demand for Old Master paintings in 2009, the Estate failed to establish an increase in sales prices for individual paintings at Sotheby’s in 2009. Additionally, Sotheby’s
Form 10K filed with the Securities and Exchange Commission for the relevant period contradicted Wachter’s assertion.

4. The Tax Court did not err in rejecting Wachter’s opinion in part because he did not support his valuations with comparable sales data. Wachter downplayed the importance of comparables in assessing value and failed to include any in his expert report. He testified that when he arrived at his valuations, he was not interested in comparables. At trial, Wachter indicated that he had reviewed comparables only after the IRS challenged his methodology.

5. The Tax Court did not err in largely accepting Dr. Cardile’s valuations. Dr. Cardile explained his methodology, reliance on comparables, and research about the paintings’ conditions. Moreover, the Tax Court did not wholly accept Dr. Cardile’s valuations, instead applying discounts for both paintings based on the evidence. See Estate of O’Connell v. Comm’r, 640 F.2d 249, 253 (9th Cir. 1981) (finding that “the Tax Court did not commit reversible error” in choosing a valuation “within the range supported by the evidence”). In its valuation, the Tax Court thoroughly considered the evidence, and its valuation plausibly flowed from the record.

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

GBP is a family-owned S corporation, and there is no dispute that the Family Transfer Restriction was incorporated into GBP’s Bylaws to ensure that the Kress family retains control of the company, to minimize the risk of disruption by a dissident shareholder, to ensure confidentiality of GBP’s affairs, and to ensure that all sales of GBP minority stock are to qualified subchapter S shareholders. The Government argues that the Restriction does not constitute a bona fide business arrangement because it does not prevent a dissident Kress family shareholder from causing management discontinuity by failing to maintain confidentiality or by starting a competing business. But the fact that the objectives of the Restriction are not fail-proof does not mean that the Restriction is not a bona fide business arrangement. The family transfer restriction significantly reduces the risk of these things occurring. To be sure, family transfer restrictions in a company’s stock may not be a way to maximize shareholder value. But they are consistent with the goals of maintaining a family business and ensuring that the business continues to provide an opportunity for family members to make a living while at the same time continuing to serve the interests of its employees and the community. These are also bona fide interests of business leaders even though not purely economic. For all of these reasons, the court finds that the family transfer restrictions satisfy the first requirement of § 2703(b).

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

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

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

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Finally, the third requirement is that the Restriction be comparable to similar arrangements entered into by persons in an arms’ length negotiation. § 2703(b)(3). The Treasury Regulations provide that Plaintiffs must submit specific evidence showing that the “right or restriction is treated as comparable to similar arrangements entered into by persons in an arm’s length transaction if the right or restriction is one that could have been obtained in a fair bargain among unrelated parties in the same business dealing with each other at arm’s length.” 26 C.F.R. § 25.2703–1(b)(4)(i). Though Plaintiffs contend restrictions like the Kress Family Restriction are common in the commercial world, they have not produced any evidence that unrelated parties dealing at arms’ length would agree to such an arrangement. For this reason, the Kress Family Restriction does not satisfy the requirement set forth in § 2703(b)(3), and it was improper for Emory to consider the Restriction in determining the discount for lack of marketability.

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

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

The “or after” seems overbroad.

The taxpayer’s experts did not believe the S corporation status affected valuation. The court agreed:
The court finds GBP’s subchapter S status is a neutral consideration with respect to the valuation of its stock. Notwithstanding the tax advantages associated with subchapter S status, there are also noted disadvantages, including the limited ability to reinvest in the company and the limited access to credit markets. It is therefore unclear if a minority shareholder enjoys those benefits.

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

1. New Proposed Alternate Valuation Regulations. [WAITING ON FINAL REGULATIONS.]

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(1) the value of the gross estate, and

(2) the sum of the tax imposed by this chapter and the tax imposed by chapter 13 with respect to property includible in the decedent’s gross estate (reduced by credits allowable against such taxes).
CCA 201926013 deals with an election made expecting the taxes to be less at the alternate valuation date, but after audit adjustments the date of death combined taxes was lower. The CCA concludes the date of death values must be used “even though the 2032 election remains completely valid.” The relevance of the election remaining completely valid is unclear.

H. SECTION 2033 – GROSS ESTATE

I. SECTIONS 2035-2038 – RETAINED INTERESTS

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

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

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

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

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

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

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

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

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

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

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

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

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

But the Court concludes, see op. Ct. p. 22, that section 2036(a) does not require “the inclusion in the value of decedent's gross estate of the full date-of-death value of the cash and securities,” while admitting that the statute, “read in isolation, would require that result.” See Estate of Thompson v. Commissioner, T.C. Memo. 2002–246, 84 T.C.M. (CCH) 374, 386 (“Section 2036(a) effectively includes in the gross estate the full fair market value * * * of all property transferred in which the decedent had retained an interest.” (Emphasis added.)). Instead, the Court holds that section 2036(a)(2) brings into the gross estate a much smaller sum: the value of the cash and securities ($10 million) minus the value of the limited partnership interest that the decedent got in exchange. Otherwise, the Court says, the $10 million would be included in her estate twice: first via section 2036(a)(2) and again via her partnership interest, which would be separately includible as property of the estate under section 2033.

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

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

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

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

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

If there is no persuasive non-tax reason for the entity, and ownership is surrendered within three years of death, then avoiding section 2036(a)(2) is difficult. One approach is to limit the decedent’s rights over the entity in the first place. For example, the client could add assets to a trust that lacks any current beneficiaries. The client would retain a testamentary power of appointment thus making the gift incomplete but the assets would be includable in the client’s estate. The trustee would engage in the discount planning, presumably under specific authority in the trust. The decedent would never have had any liquidation right or other section 2036(a)(2) right unless such were somehow imputed through the trust to the grantor.
Another approach is to sell the decedent’s interest in the entity. The issue there is whether if the sale is for less than would be included in the decedent/seller’s estate did the decedent/seller receive full consideration. In United States v. Allen, 293 F.2d 916 (10th Cir. 1961) the decedent created a trust reserving 3/5ths of the income for life; many years later she sold the income interest for far less than the value of 3/5ths of the trust. The court held that was an inappropriate loophole because – under the 1939 Code – a taxpayer could keep income for most of the taxpayer’s life and then sell close to death for a fraction of what otherwise would be included.

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

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

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

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

Although we consult State law to determine what property interests were transferred, our inquiry may not end there. See McCord v. Commissioner, 120 T.C. at 371. The Federal tax effect of a particular transaction is governed by the substance of the transaction rather than its form. Frank Lyon Co. v. United States, 435 U.S. 561, 573 (1978). The doctrine that the substance of a transaction will prevail over its form has been applied in Federal estate and gift tax cases. See Heyen v. United States, 945 F.2d 359, 363 (10th Cir. 1991); Estate of Murphy v. Commissioner, T.C. Memo. 1990-472. In particular, we have indicated a willingness to look beyond the formalities of intrafamily partnership transfers to determine what, in substance, was transferred. See Kerr v. Commissioner, 113 T.C. 449, 464-468 (1999), aff’d, 292 F.3d 490 (5th Cir. 108
We will consider both the form and the substance of decedent’s transfer to the revocable trust to determine whether the property interest transferred was an assignee interest or a limited partnership interest.

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We conclude that the form of the agreement establishes that decedent transferred to the revocable trust a limited partnership interest and not an assignee interest. The economic realities underlying the transfer of decedent’s interest also support our conclusion that the transferred interest should be treated as a limited partnership interest for Federal estate tax purposes. This is because we conclude that regardless of whether an assignee or a limited partnership interest had been transferred, there would have been no substantial difference before and after the transfer to the revocable trust. See Kerr v. Commissioner, 113 T.C. at 467-468. Pursuant to Streightoff Investments’ partnership agreement only the general partner had the right to direct the partnership’s business; neither limited partners nor assignees had managerial rights. The partnership agreement provided that assignees had no rights to any information regarding the business of the partnership or to inspection of the books or records of the partnership. However, this distinction made no difference in this case because Ms. Streightoff was both a partner entitled to information regarding Streightoff Investments and the trustee of the revocable trust.

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

J. SECTIONS 2041 AND 2514 — GENERAL POWERS OF APPOINTMENT

1. Reformation of Trusts to Limit General Powers Allowed. In PLR 201920001 the IRS was presented with trusts that looked like generation-skipping trusts but which gave beneficiaries general powers where limited powers might have been expected. The problem was discovered after both spouses who were grantors had died. The parties had the trusts referenced in a state court action:
The petition was supported by three affidavits, one each from Grantor's Accountant, Law Firm, and Son 1, in his capacity as the trustee of Trusts A and C and as representative by joinder of Trust B. Accountant swore that Grantor intended the trusts to be GST exempt. Law Firm swore that Grantor did not recognize that including the power of appointment language would result in including the trust assets in each Beneficiary's gross estate.

On Date 4, Court issued an order, effective Date 1, that limited the power of appointment language in Article III(b)(2) to exclude the Beneficiary, the Beneficiary's estate, the creditors of the Beneficiary, and the creditors of the Beneficiary estate.

On Date 5, Court issued an amended order clarifying that the trusts terminate at the death of the named grandchild and that per stirpes distributions are to be outright and in fee. The amended order clarifies that each separate trust held for a Beneficiary shall terminate upon the death of such Beneficiary. This is consistent with the provisions of each trust, as originally executed. Further, the amended order clarifies that each trust shall provide that upon such termination, the remaining principal and any undistributed income of such separate trust shall be distributed as such deceased Beneficiary may appoint to or for the benefit of one or more of the lineal descendants of the child of the Grantor (Son 1, Son 2, or Daughter, depending upon the trust) who is a lineal ascendant of such beneficiary, but excluding such Beneficiary, such Beneficiary's estate, the creditors of such Beneficiary, and the creditors of such Beneficiary's estate. The default provisions of each trust remain unchanged. Both orders were issued contingent upon a ruling from the Internal Revenue Service.

The IRS ruled:

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

Consequently, based on the facts submitted and representations made, we conclude that the Court's Orders of Date 4, Date 5, and Date 7, reforming and modifying the trust instruments based on scrivener's errors, are consistent with applicable State law that would be applied by the highest court of that state. Trusts A, B, and C, as reformed and modified pursuant to the Court's Orders, do not provide the Beneficiaries with either inter vivos or testamentary general powers of appointment over the assets of each respective Beneficiary's trust under §§ 2041(b) and 2514(c). Accordingly, based on the facts submitted and the representations made, we conclude that the judicial reformation and modification of Trusts A, B, and C do not constitute the exercise or release of a general power of appointment by a Beneficiary resulting in a gift under § 2514 and that the assets of the deceased Beneficiary's trust will not be includible in such Beneficiary's gross estate under § 2041.
2. **Power to Create or Eliminate General Powers of Appointment Allowed.** In PLR 201845006 the IRS was asked if the amendment of a trust would have any transfer tax consequences. The ruling summarizes the most interesting question as follows:

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

The IRS held:

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

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

1. **Analysis of Split Dollar Plan.** Estate of Clara M. Morrissette v. Commissioner, 146 T.C. No. 11 (2016) confronts directly the gift tax consequences of split-dollar life insurance plans. Before turning to the specific arrangement before the court, it is instructive to read the court’s understanding of split-dollar insurance and the 2003 final regulations. The opinion states:

The IRS issued final regulations in September 2003 that govern all split-dollar life insurance arrangements entered into or materially modified after September 17, 2003 (final regulations). The final regulations define a split-dollar life insurance arrangement as an arrangement between an owner and a nonowner of a life insurance contract in which: (i) either party to the arrangement pays, directly or indirectly, all or a portion of the premiums on the life insurance contract; and (ii) the party paying for the premiums is entitled to recover all or any portion of those premiums, and such recovery is to be made from, or is secured by, the proceeds of the life insurance contract. Id. para. (b)(1).
The final regulations provide two mutually exclusive regimes for taxing split-dollar life insurance arrangements entered into (or materially modified) after September 17, 2003, either the economic benefit regime or the loan regime. Id. subpara. (3)(i); see Our Country Home Enters., Inc. v. Commissioner, 145 T.C. __, __ (slip op. at 29) (July 13, 2015).

The determination of which regime applies to a split-dollar life insurance arrangement depends on which party owns, or is deemed to own, the life insurance policy subject to the arrangement. Generally, the person named as the owner in the insurance contract is treated as the owner of the contract. Sec. 1.61-22(c)(1), Income Tax Regs. A nonowner is any person other than the owner who has any direct or indirect interest in the contract. Id. subpara. (2).

As an exception to the general rule, the final regulations include a special ownership rule that provides that if the only economic benefit provided under the split-dollar life insurance arrangement to the donee is current life insurance protection, then the donor will be the deemed owner of the life insurance contract, irrespective of actual policy ownership, and the economic benefit regime will apply. Id. subpara. (1)(ii)(A)(2). If, on the other hand, the donee receives any additional economic benefit, other than current life insurance protection, then the donee will be considered the owner and the loan regime will apply. Id.

For a split-dollar life insurance arrangement to be taxed under the economic benefit regime, the owner or deemed owner will be treated as providing an annual benefit to the nonowner in an amount equal to the value of the economic benefits provided under the arrangement, reduced by any consideration the nonowner pays for the benefits. Sec. 1.61-22(d)(1), Income Tax Regs. The value of the economic benefits provided to the nonowner for a taxable year under the arrangement is equal to the sum of (i) the cost of current life insurance protection, (ii) the amount of cash value to which the nonowner has current access during the year, and (iii) any economic benefits not otherwise described that are provided to the nonowner. Id. subpara. (2).

The cost of the current life insurance protection takes into account the life insurance premium factors that the Commissioner publishes for this purpose. See id. subpara. (3)(ii). The amount of the current life insurance protection is the death benefit of the life insurance contract (including paid-up additions) reduced by the sum of the amount payable to the owner plus the portion of the cash value taxable to (or paid for by) the nonowner. See id. subdiv. (i). The amount of the insurance policy cash value is determined disregarding surrender charges or other similar charges or reductions and including insurance policy cash value attributable to paid-up additions. See id. subpara. (4)(i).

The final regulations provide that the nonowner has current access to any portion of the policy cash value to which the nonowner (i) has a current or future right and (ii) that currently is directly or indirectly accessible by the nonowner,
inaccessible to the owner, or inaccessible to the owner's general creditors. Id. subdiv. (ii).

Here, Clara M. Morrissette established a revocable trust, the Clara M. Morrissette Trust (CM Trust), and contributed her shares in the Interstate Group (a family corporation) to the trust. In 2006 the CMM Trust entered split-dollar insurance arrangements with three Dynasty Trusts established, one for each of her three sons. The CMM Trust contributed $29.9 million to the three trusts to purchase universal life insurance policies for the sons.

To provide the Dynasty Trusts with the resources to purchase the Interstate Group stock held by or on behalf of a decedent, each Dynasty Trust purchased two universal life insurance policies, one on the life of each other brother. On October 4, 2006, (i) the Arthur Dynasty Trust purchased two universal life insurance policies, one on the life of Donald and one on the life of Kenneth; (ii) the Donald Dynasty Trust purchased two universal life insurance policies, one on the life of Arthur and one on the life of Kenneth; and (iii) the Kenneth Dynasty Trust purchased two universal life insurance policies, one on the life of Arthur and one on the life of Donald.

The opinion described the split-dollar terms as follows:

To fund the purchase of the policies, each Dynasty Trust and the CMM Trust entered into two split-dollar life insurance arrangements (each a split-dollar life insurance arrangement, and collectively, split-dollar life insurance arrangements) on October 31, 2006, to set forth the rights of the respective parties with respect to the policies. The CMM Trust contributed (i) $9.96 million to the Arthur Dynasty Trust, (ii) $9.98 million to the Donald Dynasty Trust, and (iii) $9.96 million to the Kenneth Dynasty Trust. The Dynasty Trusts then used that money to pay a lump-sum premium on each policy to maintain that policy for the insured's projected life expectancy.

Under the split-dollar life insurance arrangements, upon the death of the insured the CMM Trust would receive a portion of the death benefit from the respective policy insuring the life of the deceased equal to the greater of (i) the cash surrender value (CSV) of that policy, or (ii) the aggregate premium payments on that policy (each a receivable, and collectively, receivables). Each Dynasty Trust would receive the balance of the death benefit under the policy it owns on the life of the deceased, which would be available to fund the purchase of the stock owned by or for the benefit of the deceased. If a split-dollar life insurance arrangement terminates for any reason during the lifetime of the insured, the CMM Trust would have the unqualified right to receive the greater of (i) the total amount of the premiums paid or (ii) the CSV of the policy, and the Dynasty Trust would not receive anything from the policy.

Each split-dollar life insurance arrangement includes the following recital: "WHEREAS, the parties intend that this Agreement be taxed under the economic benefit regime of the Split-Dollar Final Regulations, and that the only economic benefit provided to the [Dynasty] Trust[s] under this arrangement is current life insurance protection."

Additionally, the Dynasty Trusts executed collateral assignments of the policies to the CMM Trust to secure payment of the amounts owed to the CMM Trust. Neither the Dynasty Trusts nor the CMM Trust retained the right to borrow against a policy.
The court noted that the Preamble to the final regulations contained an example like this transaction:

As a threshold matter, the preamble to the final regulations includes an example that is structured identically to the split-dollar life insurance arrangements at issue. The preamble distinguishes between a donor, or the donor's estate, who is entitled to receive an amount equal to the greater of the aggregate premiums paid by the donor or the CSV of the contract and a donor, or the donor's estate, who is entitled to receive the lesser of those two values. T.D. 9092, sec. 5, Gift Tax Treatment of Split-Dollar Life Insurance Arrangements, 2003-2 C.B. 1055, 1062. In the former situation, the donor makes a gift to the donee equal to the cost of the current life insurance protection provided less any premium amount paid by the donee. Id. In the latter situation, the value of the donor's gift of economic benefits equals the cost of current life insurance protection provided, the amount of policy cash value to which the trust has current access, and the value of any other economic benefits, less the amount of premiums paid by the donee. Id. Thus, it follows that where a donor is to receive the greater of the aggregate premiums paid or the CSV of the contract, the possibility of the donee receiving an additional economic benefit is foreclosed.

We are aware that the Court has previously been unpersuaded by a preamble to regulations. See Allen v. Commissioner, 118 T.C. 1, 17 n.12 (2002) ("In addition to the obvious fact that these documents also are not items of legislative history, these documents are afforded little weight in this Court." (citing Dobin v. Commissioner, 73 T.C. 1121, 1127 n.9 (1980))). We are not bound by the preamble, but because it is an agency's interpretation of its statute, we apply the standard enunciated by the Supreme Court in Skidmore v. Swift & Co., 323 U.S. 134, 140 (1944). Therefore, the Commissioner is entitled to at least the lowest level of deference in interpreting his own regulations and their statutes. See United States v. Mead Corp., 533 U.S. 218, 221 (2001); ADVO, Inc. v. Commissioner, 141 T.C. 298, 322 (2013); Armco, Inc. v. Commissioner, 87 T.C. 865, 868 (1986) (explaining how a preamble is drafted and that it is a statement of intent that represents the institutional viewpoint). Here, however, the preamble is consistent with the estate's interpretation of the statute and contrary to respondent's position. While we find the logic of the preamble sound, to be thorough we will articulate why, under the final regulations, the economic benefit regime applies.

Here, the court found the special ownership rule would apply because the Dynasty Trusts had no access to cash value:

For the Dynasty Trusts to have current access under the final regulations, the Dynasty Trusts must first have a current or future right to any portion of the policy cash value. The split-dollar life insurance arrangements are structured so that upon the termination of a split-dollar life insurance arrangement during the lifetime of the insured, 100% of the CSV (including CSV attributable to premiums paid by the Dynasty Trusts) would be paid to the CMM Trust. Additionally, if a split-dollar life insurance arrangement were to terminate as a result of the death of the insured, the Dynasty Trusts would be entitled to receive only that portion of the death benefit of the policy in excess of the receivable payable to the CMM Trust. Accordingly, under the split-dollar life insurance arrangements the Dynasty Trusts had no current or future right to any portion of the policy cash value, and thus, no current access under the regulations.
Respondent argues that the Dynasty Trusts had a direct or indirect right in the cash values of the insurance policies by virtue of the terms of the 2006 Amendment to the CMM Trust. Under that amendment, the CMM Trust's interest in the cash values of the policies would pass to the Dynasty Trusts or directly to Mrs. Morrissette's sons or their heirs upon her death. However, because the CMM Trust was a revocable trust with respect to Mrs. Morrissette, she retained an absolute right to alter the CMM Trust throughout her lifetime. Accordingly, the Dynasty Trusts did not have a legally enforceable right to the cash values of the policies during the lifetime of the grantor. Furthermore, the split-dollar life insurance arrangements did not require the CMM Trust to distribute the receivables to the Dynasty Trusts. Rather, Mrs. Morrissette retained the right to receipt of the receivables.

The IRS also argued this plan was analogous to reverse-split dollar plans:

Respondent argues that the circumstances referenced in Notice 2002-59, 2002-2 C.B. 481, apply to the split-dollar life insurance arrangements at issue prohibiting the use of the economic benefit regime. Notice 2002-59, sec. 3.01, 2002-2 C.B. at 482, states:

Treasury and the Service understand that, under certain split-dollar life insurance arrangements (some of which are referred to as "reverse" split-dollar), one party holding a right to current life insurance protection uses inappropriately high current term insurance rates, prepayment of premiums, or other techniques to confer policy benefits other than current life insurance protection on another party. The use of such techniques by any party to undervalue the value of these other policy benefits distorts the income, employment, or gift tax consequences of the arrangement and does not conform to, and is not permitted by, any published guidance.

Notice 2002-59, supra, is mainly focused on reverse split-dollar life insurance arrangements. Under a typical reverse split-dollar life insurance arrangement, an irrevocable life insurance trust (ILIT) purchases a large life insurance policy, and the insured and the ILIT enters into a split-dollar life insurance arrangement. Under this arrangement, the insured is entitled to the policy's death benefit and in return pays the ILIT the greater of the actual cost of one-year term insurance or the P.S. 58 rate. This arrangement is the opposite of the typical split-dollar life insurance arrangement and thus is referred to as "reverse split-dollar". Because life insurance costs have decreased substantially since the P.S. 58 rates were set by the IRS, the insured's payment of economic benefits using the P.S. 58 rates would be substantially greater than the actual mortality charges incurred by the ILIT. With a large policy, the insured could transfer significant sums to the ILIT and, on the basis of older IRS rulings, incur little or no gift tax costs. In the most abusive cases, the insured would prepay the P.S. 58 economic benefit amounts for several years. After a few years, the parties usually terminate the arrangement. The ILIT, flush with cash from the excess payments from the insured, either maintains the policy or cashes it out.

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The split-dollar life insurance arrangements between the CMM Trust and the Dynasty Trusts bear no resemblance to the transactions Notice 2002-59, supra, is prohibiting. Mrs. Morrissette, who was 94 at the time she set into motion these arrangements, wanted the Interstate Group to remain in her family. To that
end, she caused the CMM Trust to pay a lump-sum premium, through the Dynasty Trusts, on the life insurance policies held on the lives of her sons, the proceeds of which would be employed to purchase the stock held by each of her sons upon his death. Unlike the reverse split-dollar life insurance arrangements described in the notice, the receivables the CMM Trust obtained in exchange for its advances provided the CMM Trust sole access to the CSV of the policies.

Additionally, respondent argues that the "prepaid premiums" pay not only for current insurance protection, but also for future protection, which is a benefit other than current life insurance protection and requires that the arrangement be taxed under the loan regime. This position relies on Notice 2002-59, supra, for the proposition that prepayment of future premiums (by paying a single premium) confers policy benefits other than current life insurance protection. This assertion, however, assumes that the Dynasty Trusts would otherwise be required to pay the premiums. Under the split-dollar life insurance arrangements, the Dynasty Trusts are not required, but are permitted, to pay any portion of the policies' premiums. The split-dollar life insurance arrangements were structured such that the CMM Trust was obligated to pay all the premiums. Thus, under the split-dollar life insurance arrangements, regardless of how the CMM Trust elected to pay the premiums (whether in one lump sum or over any number of installments), the CMM Trust would not relieve the Dynasty Trusts of any obligation to pay premiums because the Dynasty Trusts were not required to pay any premiums.

The risk to the taxpayer in these transactions is that the IRS will succeed on a claim that the prepaid premiums are a gift. The risk may be mitigated if a net gift is made. In Estate of Levine, T.C. No. 9345-15 (2016), the court followed Morrissette because all parties agreed it controlled.

The Tax Court denied the taxpayer’s motions for summary judgement on the application of section 2036, 2038, and 2703 to split-dollar policies in Cahill v. Commissioner, T.C. Memo. 2018-84. The court reviewed its understanding of the facts as follows:

In exchange for decedent's payment of $10 million as premiums on the policies for MB Trust's benefit, decedent received (and continued to own until he died) the right to terminate the split-dollar agreements in conjunction with the trustee of MB Trust. Each split-dollar agreement states that, upon termination, one of two things could happen: (1) MB Trust could opt to retain the policy, in which case decedent would immediately receive the greater of premiums paid or cash surrender value with respect to the related policy, or (2) MB Trust could decline its option to retain the policy, in which case the policy would be transferred to Northern Trust, N.A., in full or partial satisfaction of decedent's liability to Northern Trust, N.A. (We will refer to these as the termination rights.)

Additionally, each split-dollar agreement states that upon the death of the insured, decedent would receive the greatest of the remaining loan balance, premiums paid, or cash surrender value. (We will refer to these as decedent's death benefit rights.) MB Trust would receive any excess of the death benefits over the amount required to be paid to decedent. (We will refer to these as MB Trust's death benefit rights.)

On its estate tax return, the estate claimed that the aggregate value of all the rights decedent held under the split-dollar agreements, including the termination rights, was $183,700. The estate contends that (1) because decedent's right to
terminate the split-dollar agreements was held in conjunction with the trustee of MB Trust and (2) because it would allegedly never make economic sense for MB Trust to allow termination of the split-dollar agreements, termination was so unlikely that the termination rights had no value as of decedent's date of death. On this basis, the estate contends that the value of decedent's interests in the split-dollar agreements is limited to the value of decedent's death benefit rights. The estate further contends that on decedent's date of death these rights were worth only $183,700, because Patrick and Shannon Cahill, the insured persons, were then projected to live for many years, with the result that decedent's rights had only a relatively small present value.

In the notice of deficiency respondent adjusted the total value of decedent's rights in the split-dollar agreements from $183,700 to $9,611,624; i.e., to the aggregate cash surrender value of the policies as of decedent's date of death. In support of this adjustment, respondent presents alternative theories applying sections 2036(a)(2), 2038(a)(1), and 2703(a)(1) and (2). The estate seeks summary judgment that sections 2036, 2038, and 2703 are inapplicable; it looks for support for its position in section 1.61–22, Income Tax Regs.

The court concluded that those may, or may not, have been a bona fide sale for full and adequate consideration:

There are many unresolved factual questions with respect to whether this transfer had a legitimate business purpose. For instance: (1) Were these arrangements actually intended to provide liquidity decades from now, or were they intended merely to eliminate the cash surrender value from decedent's estate? (2) The guaranteed return (3%) on the investment in the policies appears to be lower than the interest rate on the loan decedent used to purchase the policies (one month LIBOR plus 1.14%); taking into account all of the economic facts and circumstances, would this arrangement actually be capable of providing liquidity decades from now? How much liquidity, in present valued terms (i.e. valued to the date of execution)? At what cost, in present valued terms? And (3) why was an arrangement intended to provide liquidity potentially decades from now funded with a loan that required a balloon payment of the entire principal amount after only five years? That is, if decedent was acting as a prudent business person, why did he fund a long-term obligation with a short-term loan? Because such questions remain, summary judgment is inappropriate with respect to whether decedent's transfer of $10 million was part of a bona fide sale.

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According to the estate, at decedent's date of death MB Trust's ability to veto decedent's termination of the agreements rendered the termination rights valueless. Additionally, the estate alleges that decedent's death benefit rights are worth less than 2% of the cash surrender value (i.e., $183,700 ÷ $9,611,624 < 2%). But MB Trust's veto power existed from the moment decedent entered into these split-dollar agreements, and nothing in the undisputed facts presently before us suggests that the terms of the split-dollar agreements were altered between execution of the agreements and decedent's date of death; consequently, this alleged 98% discount must have been present from the execution of these agreements. Therefore, according to the estate's valuation theory, the initial transfer of $10 million in value cannot have been in exchange for property worth that amount; i.e., under the estate's argument, what decedent received was necessarily worth at least 98% less than what he transferred (even without taking
into account the amounts used to pay commissions and fees to the insurance company). Consequently, at least according to the estate's valuation theory, the value of what decedent received (allegedly, something close to $183,700) was not even roughly equal to the $10 million decedent paid.

The court believes that section 2703 may apply on a simple reading of the statute:

On the basis of the undisputed facts, we conclude that under section 2703(a)(1) the split-dollar agreements, and specifically the provisions that prevent decedent from immediately withdrawing his investment, are agreements to acquire or use property at a price less than fair market value. The estate claims that decedent paid $10 million to the insurance companies for the benefit of MB Trust and in return received certain rights, namely, the termination rights (which the estate claims are worthless) and decedent's death benefit rights (which, according to the estate's valuation theory, are worth less than 2% of the cash surrender value). MB Trust, meanwhile, paid nothing into this arrangement and received MB Trust's death benefit rights. As best we understand the estate's valuation theory, MB Trust's death benefit rights are allegedly worth at least the cash surrender value minus the value of decedent's death benefit rights (i.e., $9,611,624—(allegedly) $183,700 = $9,427,924). Nothing in the parties' filings suggests that MB Trust ever paid, or was obligated to pay, any interest or other amount to compensate decedent for MB Trust's acquisition and use of this amount.

The court rejected an analogy of a split-dollar agreement to notes or partnership and held that 2703 may apply:

We note that most of the estate's arguments with respect to section 2703(a) are generally to the effect that, if section 2703(a) applies in this case, it would also apply to all sorts of other options, agreements, rights, and restrictions. For example, the estate argues that “almost every two-party agreement has a restriction that one party cannot just unilaterally terminate the agreement.” The estate's implicit claim would appear to be that its hypothetical restriction is so obviously legitimate that Congress could not have meant for section 2703(a) to apply. But section 2703(b) provides the exceptions to application of section 2703(a); in particular, section 2703(b)(3) specifically provides for comparison of the terms of the option, agreement, right, or restriction to “similar arrangements entered into by persons in an arms' length transaction.” The estate's vague and general arguments by way of comparison are therefore more appropriate as part of a section 2703(b)(3) analysis. And because the parties have yet to address whether section 2703(b) applies in this case, we decline to consider it.

The case of Machacek v. Commissioner of the Internal Revenue, 906 F.3d 429 (6th Cir. 2018), dealt with an interesting split-dollar income tax question. The opinion summarizes the issue as follows:

Petitioners-appellants John J. Machacek, Jr. (John Machacek) and Marianne Machacek (together, the Machaceks), a married couple, were the sole shareholders of John J. Machacek, Jr., Inc. (Machacek, Inc.), a corporation organized under Subchapter S of the Internal Revenue Code (an S corporation). John Machacek was also an employee of Machacek, Inc. The Machaceks appeal the Tax Court’s ruling requiring them to treat as income the economic benefits resulting from Machacek, Inc.'s payment of a premium on John Machacek’s life insurance policy under a compensatory split-dollar arrangement. Relying on the compensatory nature of the arrangement, the Tax Court rejected the Machaceks’
argument that the economic benefits should be treated as a shareholder distribution.

Because the Tax Court did not consider the impact of a provision of the tax regulations specifically requiring that such economic benefits be treated as shareholder distributions, we reverse the Tax Court’s decision and remand for further proceedings consistent with this opinion.

I. Background

In 2002, Machacek, Inc. adopted the Sterling Benefit Plan in order to provide certain benefits to its employees. Pursuant to the plan, Machacek, Inc. provided John Machacek with a life insurance policy and paid the $100,000 annual premium in the 2005 tax year; both Machacek, Inc. and the Machaceks filed timely tax returns for that year. Because Machacek, Inc. is an S corporation, its income, losses, deductions, and credits are “passed through” to shareholders for tax purposes. Machacek Inc. deducted the $100,000 premium, and that amount was thus not included in the Machaceks’ individual income. The Machaceks also did not include as individual income the economic benefits flowing from the increase in value of the life insurance policy.

The Tax Court determined that Machacek, Inc. was not entitled to deduct the $100,000 premium payment. Because the $100,000 premium payment was not deductible, Machacek, Inc. underreported its income for that year and, due to the pass-through nature of S corporations, the increased income was passed through to the Machaceks, who were then required to pay income tax on that amount. The non-deductibility of the premium payment is not disputed, and the Machaceks concede that they must report the amount of the premium payment as pass-through income.

The dispute here concerns the tax treatment of the economic benefits flowing to John Machacek as a result of Machacek, Inc.’s payment of the premium. The parties dispute whether the Machaceks are required to report as taxable income—in addition to the pass-through amount of the premium—the economic benefits flowing from the increase in value of the life insurance policy caused by the payment of the premium.1

The opinion is fascinating because the Court ultimately relied on a regulation uncited by either party. The taxpayer argued for a four step analysis:

At the first step, the Machaceks argue that notwithstanding that the economic benefits here flowed from a compensatory split-dollar arrangement, the regulations require that the economic benefits “be treated as a ‘distribution of property’ from the corporate-owner (Machacek, Inc.) to the non-owner (Mr. Machacek).” (Appellants’ Br. at 17.) This step of the argument relies on 26 C.F.R. § 1.301-1(q)(1)(i), which states that the provision of economic benefits “by a corporation to its shareholder pursuant to a split-dollar life insurance arrangement ... is treated as a distribution of property.” Neither the Machaceks nor the Commissioner addressed this regulation before the Tax Court, and the Tax Court made no mention of this regulation.

At the second step, the Machaceks point to the fact that “distributions of property” to a shareholder are ordinarily governed by 26 U.S.C. § 301(c). See 26 U.S.C. § 301(a) (“[A] distribution of property ... made by a corporation to a
shareholder with respect to its stock shall be treated in the manner provided in [§ 301(c)].

At the third step, the Machaceks argue that Subchapter S—rather than § 301(c)—governs the treatment of the distribution here because Machacek, Inc. is an S corporation. See 26 U.S.C. § 1368(a) (“distribution of property made by an S corporation with respect to its stock to which (but for this subsection) section 301(c) would apply shall be treated in the manner provided” by Subchapter S).

At the fourth step, the Machaceks argue that Subchapter S mandates that any shareholder distribution “taxable under the Subchapter S provisions ... would escape taxation under the split-dollar regulations.” (Appellants’ Br. at 17.)

The IRS thought that the mere fact that the arrangement was a compensatory split-dollar arrangement was determinative:

The Commissioner correctly notes that such treatment would be uncontroversial if the recipient of the economic benefits were an ordinary employee, rather than an S corporation’s shareholder-employee. The distinction between John Machacek’s different roles—employee and shareholder—is therefore key to the Commissioner’s position.

In response to the Machaceks’ reliance on § 1.301-1(q)(1)(i), the Commissioner points only to the distinction between compensatory and shareholder arrangements. The Commissioner recognizes that § 1.301-1(q)(1)(i) applies to both compensatory and shareholder arrangements but concludes that it “does not mean that in any situation where a compensatory arrangement covers a shareholder, the taxpayer’s status as a shareholder trumps his status as an employee, causing the economic benefit to be treated as a distribution to a shareholder,” because “[s]uch an interpretation of the regulation would make no sense, as it would defeat the reason for distinguishing between a compensatory arrangement and a shareholder arrangement.” (Appellee’s Br. at 37.)

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Finally, the Commissioner notes that “Machacek, Inc. will be entitled to a deduction in a future tax year,” pursuant to 26 C.F.R. § 1.83-6(a)(5), “when it actually transfers ownership of the policy to John Machacek.” (Appellee’s Br. at 41; see also id. at 26.) The Commissioner appears to rely on a possible future deduction as a way to counter the Tax Court’s acknowledgement that the result below “may seem aberrational.” The Commissioner argues that “it is [the Machaceks], not the Commissioner, who are arguing for an inequitable result under which they would escape taxation on the accumulation value of the policy, and realize an additional tax advantage when their corporation deducts the cost of the policy in the future.” (Appellee’s Br. at 41.) However, the Machaceks will also have personal tax consequences when the policy is transferred.

Finally, the Court reaches what it concludes is the dispositive regulation:

In finding for the Commissioner, the Tax Court did not address 26 C.F.R. § 1.301-1(q)(1)(i). Neither party cited or relied on this regulation below, and we are aware of no case discussing the regulation in any context. But given its importance in this scenario, we cannot simply ignore it. If the economic benefits
to John Machacek are properly treated as a distribution of property to a shareholder—rather than as compensation to an employee—then the Tax Court erred.

Section 1.301-1(q)(1)(i) is dispositive and renders irrelevant whether John Machacek received the economic benefits through a compensatory or shareholder split-dollar arrangement. Section 1.301-1(q)(1)(i) treats economic benefits provided to a shareholder pursuant to any split-dollar arrangement as a distribution of property within the ambit of § 301. And, although another subsection of that regulation, 26 C.F.R. § 1.301-1(c), states that the regulation as a whole “is not applicable to an amount paid by a corporation to a shareholder unless the amount is paid to the shareholder in his capacity as such,” the explicit inclusion in § 1.301-1(q)(1)(i) of all arrangements described in § 1.61-22(b)(2)—which includes compensatory arrangements—makes clear that when a shareholder-employee receives economic benefits pursuant to a compensatory split-dollar arrangement, those benefits are treated as a distribution of property and are thus deemed to have been paid to the shareholder in his capacity as a shareholder. The Commissioner offers no alternative interpretation that gives meaning to the inclusion of compensatory arrangements in § 1.301-1(q)(1)(i). Our interpretation is further supported by the fact that § 1.61-22(d) states that the tax treatment of the economic benefits depends on the “relationship between the owner and the non-owner.” The Commissioner argues that this language shows that the tax treatment depends on the nature of the split-dollar arrangement—compensatory or shareholder—but if that were the controlling factor, the regulation could have said so. It does not.

One conclusion could be that the split-dollar regulations are too complicated to be understood or implemented.

I. SECTION 2053 and 2054 - DEBTS AND ADMINISTRATION EXPENSES

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

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

Petitioner argues that Clyde Sr. and Jewell created Turner & Co. for at least one of the following legitimate and significant nontax reasons:

(1) To consolidate their assets for management purposes and allow someone other than themselves or their children to maintain and manage the family's assets for future growth pursuant to more active and formal investment management strategy; (2) to facilitate resolution of family disputes through equal sharing of information; and (3) to protect the family assets and Jewell from Rory, and protect Rory from himself.

The objective facts in the record fail to establish that any of these reasons was a legitimate and significant reason for formation of Turner & Co.
In reaching our conclusion that asset management was not a significant nontax purpose, we rely on our finding that Turner & Co.’s portfolio of marketable securities did not change in a meaningful way. Regents Bank stock continued to dominate the portfolio from the time of the partnership formation until Clyde Sr.’s death. Whatever assets Turner & Co. added to the portfolio had a risk/return profile similar to the profile of the assets Clyde Sr. and Jewell contributed to the partnership. For example, the account statements for Turner & Co.’s Wachovia Securities account reflect only four purchases up to the date of Clyde Sr.’s death: GMAC Notes, Morgan Stanley preferred stock, Ford Motor preferred stock, and Suburban Propane Partners common stock. The account statements of Turner & Co.’s Morgan Keegan accounts also show only a few purchases. According to those statements, Turner & Co. purchased Ford Motor Credit preferred stock (three purchases), GMAC Notes, GMAC Smart Notes, and General Electric notes. With the exception of common stock of Suburban Propane Partners, Turner & Co. therefore generally added to its portfolio fixed-income investments. Turner & Co. therefore continued to hold a portfolio consisting of common stock of mostly bank companies, preferred stock, bonds, cash, and cash equivalents, similar to what Clyde Sr. and Jewell held individually. As a consequence, handing management over the assets to Marc and Turner had no material impact on the profit potential of the portfolio.

Petitioner points to the fact that Turner & Co. opened and closed certificates of deposit at various banks to support petitioner’s claim of active investing. Yet certificates of deposit are akin to cash equivalents, and renewing certificates of deposit can hardly be considered pursuing a diversified strategy. The objective facts in the record do not support petitioner’s argument that Turner & Co. was formed to consolidate Clyde Sr. and Jewell’s assets and allow for centralized management pursuant to a formal investment strategy or to pursue a more aggressive investment strategy.

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

The parties agree that Clyde Sr. made indirect gifts to the beneficiaries of Clyde Sr.’s Trust when he paid the premiums on life insurance policies for the benefit of his children and grandchildren. The parties disagree, however, on the nature of the gifts. Petitioner contends that the gifts were gifts of present interests (and therefore subject to the annual exclusion) because the beneficiaries had the absolute right and power to demand withdrawals of amounts transferred to Clyde Sr.’s Trust. Respondent contends that the gifts were gifts of future interests (and therefore not subject to the annual exclusion). Specifically, respondent argues the beneficiaries’ withdrawal rights were illusory because Clyde Sr. did not deposit money with the trustees of Clyde Sr.’s Trust but instead paid the life insurance premiums directly and because the beneficiaries did not receive notice of the transfers. Consequently, respondent argues that the beneficiaries had no meaningful opportunity to exercise the right of withdrawal.

The terms of Clyde Sr.’s Trust gave each of the beneficiaries the absolute right and power to demand withdrawals from the trust after each direct or indirect transfer to the trust. The fact that Clyde Sr. did not transfer money directly to Clyde Sr.’s Trust is therefore irrelevant. Likewise, the fact that some or even all of the beneficiaries may not have known they had the right to demand withdrawals from the trust does not affect their legal right to do so. See
Crummey v. Commissioner, supra at 86-87; Estate of Cristofani v. Commissioner, supra at 80. We therefore conclude that the premium payments Clyde Sr. made as indirect gifts to Clyde Sr.’s Trust in 2000-2003 were gifts of present interests and are subject to the annual exclusion.

Respondent argues, in the alternative, that even if we conclude the premium payments were gifts of present interests, some of the gifts made in 2002 and 2003 -- specifically, the gifts made to Clyde Jr., Betty, Janna, Trey, and Rory -- are still includable in Clyde Sr.’s taxable estate. This is so, respondent argues, because the transfers of limited partnership interests to Clyde Jr., Betty, Janna, Trey, and Rory in 2002 and 2003 used up their annual exclusions and any additional gifts to those beneficiaries during 2002 and 2003 are includable in Clyde Sr.’s estate. We disagree.

For the reasons discussed above, we have concluded that the value of property Clyde Sr. transferred to Turner & Co. is included in his gross estate under section 2036. Consequently, the gifts of limited partnership interests that the estate reported on Forms 706 and 709 must be disregarded for purposes of calculating Clyde Sr.’s adjusted taxable gifts. To do otherwise would result in the double inclusion of a significant part of the property transferred to Turner & Co. in Clyde Sr.’s estate.

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

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

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

Under section 2036 the gross estate includes the values of the section 2036 assets that Clyde Sr. transferred during his lifetime. The fact that property that might otherwise go to the surviving spouse would be used to pay the estate tax liabilities attributable to the section 2036 assets does not compel a conclusion that the marital deduction must be reduced. The estate is entitled to recover from
the recipients of section 2036 assets during Clyde Sr.’s lifetime an amount equal
to the liability attributable to the section 2036 inclusion that the estate pays. That
recovery will enable the estate to distribute to the surviving spouse property
value undiminished by the tax payments. Section 20.2056(b)-4(c), Estate Tax
Regs., does not require a different result when the Federal estate and State death
taxes have no effect upon the net value distributable to the surviving spouse.
See, e.g., Estate of Gill v. Commissioner, T.C. Memo. 2012-7 (marital deduction
not reduced where marital deduction property does not bear the economic
burden of the tax). Accordingly, we hold that the estate need not reduce the
marital deduction by the amount of Federal estate and State death taxes it must
pay because the tax liabilities are attributable to the section 2036 assets, the
estate has the right to recover the amount paid under section 2207B, and the
estate must exercise that right to recover to give effect to Clyde Sr.’s intention
that Jewell receive her share of the estate undiminished by the estate’s tax
obligations.

What of the argument that the estate might not seek reimbursement? The opinion concludes that won’t happen.

Section 2207B is one of several Code sections that provide for a right of
recovery for certain types of property or dispositions. Unless the will of a
Georgia decedent expressly directs otherwise, Georgia law does not limit any
rights to reimbursement for Federal estate taxes and other taxes that may be
available to the executor under Federal law. See Ga. Code Ann. sec. 53-4-63(e).

As discussed above, Clyde Sr.’s will does not address the payment of taxes or
their apportionment, nor does it express any intent regarding the right of
recovery under section 2207B or any other right of recovery provision. This is
not surprising because Clyde Sr. did not know that the Court would apply
section 2036 to his lifetime transfers. Item Eight of Clyde Sr.’s will, however,
clearly manifests his intention that the marital deduction not be reduced or
diminished by the estate’s tax liabilities. It is reasonable to assume that Clyde
Sr. would want his executor to take all steps necessary to ensure that the
property passing to his surviving spouse and qualifying for the marital deduction
not be impaired

Respondent argues that the right of recovery under section 2207B cannot
preserve the maximum marital deduction because the right of recovery can be
exercised only after taxes have been paid. However, the fact that the estate may
exercise the right of recovery under section 2207B only after the taxes have
been paid does not require that the marital deduction be reduced by the tax
payment amounts.

The court recognizes the issue and states in footnote 9:

The parties do not address Estate of Wycoff v. Commissioner, 506 F.2d 1144
(10th Cir. 1974), aff’g 59 T.C. 617 (1973), but we find it appropriate to
distinguish this case. In Estate of Wycoff v. Commissioner, 506 F.2d at 1146,
the decedent’s will created two trusts, one in favor of his wife and the other for
the benefit of his son. The decedent directed that Federal estate and State death
taxes be paid out of the portion of his estate that was not in the marital trust; but
at the same time, he granted the executor discretion to pay these taxes out of the
marital trust if the executor considered it prudent to do so. The U.S. Court of
Appeals for the Tenth Circuit reasoned that although the will expressed a
preference for payment from the part of the estate not included in the marital trust, the will contained no positive direction that Federal estate and State death taxes be paid from the part of the estate not included in the marital share. Id. at 1150. The Court of Appeals stated: “[A]s we view it such an express provision would be necessary to justify a ruling for the executor” and held that “§ 2056(b)(4) renders the marital share available to the surviving spouse subject to the payment of death taxes.” Id. As a result, the Court of Appeals held that the value of the marital deduction had to be reduced by the amount of the applicable taxes.

Estate of Wycoff is distinguishable because the executor of the estate could choose from which trust to pay the expenses. In this case, however, Clyde Sr.’s will is silent as to the payment of taxes, and we have found that Clyde Sr. wanted to maximize the marital deduction and that the executor must exercise the right of recovery under sec. 2207B.

A marital deduction for income earned during the estate was not allowed.

N. SECTIONS 2501 TO 2524 – GIFTS

1. Gift of Art is Complete. The taxpayer asked for a ruling that the gift of a remainder interest in art would be incomplete in PLR 201825003. The ruling was denied because the taxpayer had abandoned dominion and control over the art. The ruling recited the following simple facts:

On Date 2, prior to Spouse’s death, Taxpayer and Spouse entered into a Deed of Transfer (“DOT”) with two museums (“Museums”) located in Country. Under the DOT, Taxpayer and Spouse agreed to donate the artwork to Museums, with possession of the artwork to transfer to Museums on the death of the second of Taxpayer and Spouse. Museums desired to accept the artwork to effectuate Taxpayer and Spouse’s donative purpose and enhance its collection of artwork. The estimated value of the artwork at the time of the execution of the DOT was $x.

The DOT, as it currently applies to Taxpayer as the surviving spouse and sole owner of the artwork, provides that Taxpayer shall grant to the Museums the legal title, naked ownership and remainder interest in and to the artwork. The DOT further provides that Taxpayer shall expressly reserve for her benefit a life interest and usufruct in and to the artwork. The life interest and usufruct shall automatically expire on the death of Taxpayer.

Section 3.1 of the DOT provides that the parties intend for the transfer of artwork to not qualify as a completed inter vivos gift for United States gift tax purposes on the basis that Taxpayer is not releasing dominion and control over the artwork until her death. If Taxpayer receives a favorable ruling on the gift tax treatment, the donation under the DOT is deemed to take effect as of the date of the favorable ruling. If Taxpayer does not obtain a favorable ruling, then the DOT does not come into force.

Section 3.2 imposes certain conditions subsequent. If any of the conditions subsequent are not satisfied, Taxpayer would have the option to revoke the transfer of the artwork. The conditions subsequent, which apply during the life of Taxpayer are: (i) Museums must comply with the requirements regarding the housing, display and exhibition of the artwork as set forth in the DOT (applicable to artwork delivered to Museums prior to Taxpayer’s death pursuant
to Section 4.1.1); (ii) the X law principles currently governing in Country must not be replaced by Y law; (iii) Museums must not become privately owned; and (iv) the tax laws of Country must not change to cause Taxpayer to become subject to taxation in Country during Taxpayer’s life or upon death in connection with the transfer of the artwork.

Here, the IRS concluded that none of the factors that could terminate the gift were within the taxpayer/donor’s control. However, because the ruling was negative, the gift did terminate.

O. SECTION 2518 – DISCLAIMERS

P. SECTIONS 2601-2654 - GENERATION-SKIPPING TRANSFER TAX

1. **Trust Construction Does Not Affect Grandfathered Status.** The issue in PLR 201814001 was whether adopted persons were included as beneficiaries in a grandfathered trust. The ruling states:

   Under State common law, it is well settled that the intent of a settlor controls in interpreting the terms of a will or a trust. Citation 1; Citation 2. If that intent is not evident from the plain meaning of the words of the instrument, then the circumstances and facts surrounding the creation of the trust are consulted; and then only as a last resort are the canons of construction used. *Id.*

   At the time Trust was executed, there was a well-established State common law rule that, in the absence of any demonstration of the actual intent of the testator, a presumption arose that the words “child” or “children” excluded adopted children. See *Citation 3.* After Trust was established, a new rule of construction was adopted, reversing the prior State common law precedent. *Id.* Under the new rule of construction, absent contrary intent by the settlor, the word “children” would be read to include adopted persons. *Id.*

   In this case, the terms of Trust present a bona fide issue regarding whether an adopted grandchild of Settlor is considered a member of the class of “issue,” “descendants,” or “children” and therefore a beneficiary of Trust. State Court’s order construing the ambiguous terms is consistent with applicable state law that would be applied by the highest court of the state. Accordingly, based on the facts submitted and the representations made, the State Court’s order construing Trust will not affect the exempt status of Trust for purposes of the GST tax and will not result in a transfer of property that will subject Trust or distributions thereunder to the GST tax imposed under § 2601.

   There were no gift tax or income tax issues either.

Q. SECTIONS 2701-2704 - SPECIAL VALUATION RULES

1. **How Might The Doctrine Of Merger Be Used With A GRAT?** Because a trust is created by separating legal and equitable title to property, merging legal and equitable title to property in one person will, in general, cause the trust to terminate. The doctrine of merger is incorporated in section 402(a)(5) of the UTC, the comment to which states:

   Subsection (a)(5) addresses the doctrine of merger, which, as traditionally stated, provides that a trust is not created if the settlor is the sole trustee and
sole beneficiary of all beneficial interests. The doctrine of merger has been inappropriately applied by the courts in some jurisdictions to invalidate self-declarations of trust in which the settlor is the sole life beneficiary but other persons are designated as beneficiaries of the remainder. The doctrine of merger is properly applicable only if all beneficial interests, both life interests and remainders, are vested in the same person, whether in the settlor or someone else. An example of a trust to which the doctrine of merger would apply is a trust of which the settlor is sole trustee, sole beneficiary for life, and with the remainder payable to the settlor’s probate estate.

The Restatement (Third) of Trusts § 69, Comment b, states that “[i]f, by operation of law, the legal title to the trust property passes to the beneficiary who has the entire beneficial interest, merger occurs, the trust terminates, and the beneficiary holds the property free of trust. Where the life interest and remainder interest is held by two beneficiaries who are also the only co-trustees, whether merger occurs in favor of the two beneficiaries is uncertain. See Scott and Ascher on Trusts § 11.2.5.

Suppose the grantor and the remainder beneficiaries contribute their respective interests to an LLC in exchange for membership interests that are proportionate to the interests of each such that the grantor receives an interest equal in value to the amount that would be included in the grantor estate if she died at that moment. The LLC would have all the beneficial interests in the GRAT property. If the LLC could become trustee of the GRAT then the doctrine of merger ought to apply. May an LLC serve as trustee? Under the UTC, for example, there is no definition of trustee but there are broad references to “persons” serving as trustee and the definition of person includes entities like an LLC. Some states may impose other limitations.

Where an LLC cannot serve as trustee, if the LLC managers serve as trustees is that sufficient? The answer is uncertain. The LLC managers are not the LLC.

Would a merger into an LLC be a taxable event for income tax purposes? The answer would seem to be no. Similarly, because the grantor receives an LLC interest having a value equal to what would be in the grantor’s estate if the grantor died at that moment concerns like those raised in CCA 201745012 arguably are avoided.

2. GRAT Inclusion. Treas. Reg. §20.2036-1(c)(2)(i) applies section 2036 to a GRAT. When the grantor dies during the GRAT term, an amount of the GRAT is included in the grantor’s estate which is sufficient to produce the annuity using the section 720 rate then in effect (with special rules for annuities, that change during the term). As a practical matter, absent a substantial increase in the section 7520 rate between the date of the GRAT and the grantor’s death, an extraordinary appreciation, all of a GRAT is included in the Grantor’s estate at death. An exception is for GRATs with long terms, perhaps as long as 99 years, because the annuity required to zero out over such a long-term is very low.

In Badgley v. United States, 2018 WL 2267566 (N.D. Ca. 2018) the taxpayer challenged the regulation where the GRAT term was 15 years. The taxpayer lost. The opinion states:
Plaintiff contends that the Court should disregard the Regulation as an unreasonable interpretation of section 2036 as applied to Patricia’s GRAT. See Pl. Mot. at 24 (citing Prof’l Equities v. Commissioner, 89 T.C. 165 (1987)). Defendant argues that the Regulation is a reasonable interpretation of section 2036 and valid under Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837 (1984). Plaintiff does not expressly dispute that Chevron applies; instead, Plaintiff claims that the Regulation is interpretive and thus given less deference as compared to a legislative rule. See Pl. Opp. at 19.

The Court applies Chevron’s two-step framework. See Mayo Found. for Med. Educ. & Research v. United States, 562 U.S. 44, 52 (2011). At Chevron step one, the Court asks “whether Congress has directly addressed the precise question at issue.” Id. (quotation omitted). The parties agree that section 2036 does not expressly address whether annuity payments constitute some possession, enjoyment, or right to income from the transferred property. Def. Mot. at 14; Pl. Mot. at 19. So the Court proceeds to step two. At that step, the Court “may not disturb an agency rule unless it is arbitrary or capricious in substance, or manifestly contrary to the statute.” Mayo Found. for Med. Educ., 562 U.S. at 53 (quotation omitted).

The Court concludes that the Regulation is reasonable, and valid under Chevron. In drafting the Regulation, the IRS and Treasury Department relied principally on the above discussed binding authorities, including Church’s, Hallock, and Spiegel’s. See Grantor Retained Interest Trusts—Application of Sections 2036 and 2039, T.D. 9414, 73 Fed. Reg. 40173-01 (July 14, 2008) at 40174. Those cases support Defendant’s view of section 2036, which parallels the Regulation’s interpretation of that section. The IRS and Treasury Department also drew on section 2036’s legislative history to devise the Regulation, observing that Congress amended section 811(c) to include interests retained for a term of years. Id. (citing H.R. Rep. no. 81-1412 at 9 (1949)). Though Plaintiff cites legislative history for the opposite conclusion, Plaintiff does not explain why that history supports the Regulation. See Pl. Opp. at 20.

Overturning a final regulation is difficult. Here the regulation was designed to be anti-taxpayer. Inclusion with one payment to go is calculated the same as on day 2 of the GRAT. The regulation writers did not expect very low section 7520 rates. The taxpayer has appealed arguing that an annuity is not a retained right to income or use, and the valuation approach of the regulations should be thrown out.

Suppose the grantor of the GRAT is unlikely to survive the term. A remainder interest purchase strategy was tried in CCA 201745012 which the IRS described as follows:

ISSUES

(1) Whether the remainder interest in transferred property in which the donor has retained an annuity replenishes the donor’s taxable estate so as to constitute adequate and full consideration in money or money’s worth for gift tax purposes where the purchase of the remainder occurs on the donor’s deathbed during the term of the annuity.

(2) Whether a note given in exchange for property that does not constitute adequate and full consideration in money or money’s worth for gift tax purposes is deductible as a claim against the estate.
CONCLUSIONS

(1) Where the purchase of the remainder occurs on the donor’s deathbed during the term of the annuity, the remainder does not replenish the donor’s taxable estate. Accordingly, the remainder does not constitute adequate and full consideration in money or money’s worth for gift tax purposes. Merrill v. Fahs, 324 U.S. 308 (1945).

(2) A note given in exchange for property that does not constitute adequate and full consideration in money or money’s worth for gift tax purposes is not deductible as a claim against the estate.

The purchase occurred the day before the grantor died. The essence of the replenishment argument was outlined by the IRS:

In Commissioner v. Wemyss, 324 U.S. 303 (1945), the Supreme Court considered the meaning of the term “adequate and full consideration in money or money’s worth” for gift tax purposes. There, the donor transferred assets to his fiancé to compensate her for the loss of an income interest that would terminate upon her marriage to him. There was no dispute that both a promise of marriage and detriment to a contracting party constituted valuable consideration for purposes of the law of contracts. The Tax Court had held that if the promise of marriage was the consideration, it was not one reducible to a money value and if the fiancé’s loss of the income interest was the consideration, it did not constitute consideration in the hands of the donor.

If we are to isolate as an independently reviewable question of law the view of the Tax Court that money consideration must benefit the donor to relieve a transfer by him from being a gift, we think the Tax Court was correct. . . . The section taxing as gifts transfers that are not made for ‘adequate and full (money) consideration’ aims to reach those transfers which are withdrawn from the donor’s estate. To allow detriment to the donee to satisfy the requirement of ‘adequate and full consideration’ would violate the purpose of the statute and open wide the door for evasion of the gift tax.

Wemyss, 324 U.S. at 307-08. In other words, valuable contractual consideration in the hands of the donor is not sufficient; adequate and full consideration is that which replenishes, or augments, the donor’s taxable estate.

Wemyss had a companion case, Merrill v. Fahs, 324 U.S. 308 (1945), which was also a gift tax case. Merrill and its predecessors likewise involved situations where A transferred property to B, A’s fiancé or spouse, in exchange for B’s relinquishment of marital rights in A’s remaining property. Both Wemyss and Merrill have come to stand for the general proposition that “adequate and full consideration in money or money’s worth” for gift tax purposes is that which replenishes, or augments, the donor’s taxable estate. See Steinberg v. Commissioner, 141 T.C. 258, 266 (2013) (noting that under the estate depletion theory, a donor receives consideration in money or money’s worth only to the extent that the donor’s estate has been replenished), citing Wemyss, at 307-08, and Randolph E. Paul, Federal Estate and Gift Taxation, para. 16.14, at 1114-15 (1942).1 See also I.R.C. § 2043(b)(1) (“Transfers for Insufficient Consideration”). Thus, B’s relinquishment of marital rights in A’s property will have no effect on the includible value of that property in A’s gross estate. Accordingly, the relinquishment of marital rights cannot replenish a donor’s
gross estate for estate tax purposes, and thus cannot constitute adequate and full consideration for gift tax purposes. See also Commissioner v. Bristol, 121 F.2d 129, 136 (1st Cir. 1941).

It is important to keep in mind that in each of the above cases, the relinquishment of the marital rights in the donor’s remaining assets did constitute valuable contractual consideration in the hands of the donor, and did benefit the donor. It enabled the donor to dispose of that property free of the spousal claims of the second marriage. See Merrill v. Fahs, 324 U.S. at 309. For instance, Bristol involved the waiver of spousal claims against a family business that the donor wished to bequeath to the children of his first marriage. Bristol, 121 F.2d at 131. Indeed, in each of these cases, it was the prospective husband’s desire to dispose of his property as he chose that was the basis of the antenuptial agreement. This freedom did not constitute adequate and full consideration, however, because it did not augment the husband’s taxable estate.

Here, it cannot be disputed that Donor’s liability on the promissory notes depleted Donor’s taxable estate. However, in the context of a deathbed purchase of a remainder interest in transferred property in which a donor has retained a § 2036 “string,” the receipt of the remainder does not increase the value of the donor’s taxable estate, because the value of the entire property, including that of the remainder, will be includible in the donor’s gross estate pursuant to § 2036(a)(1). Thus, Donor’s receipt of the remainder interests cannot constitute adequate and full consideration within the meaning of § 2512(b). Commissioner v. Wemyss, 324 U.S., at 307-08. Cf. Rev. Rul. 98-8, 1998-1 C.B. 541 (reaching a similar conclusion for gift tax purposes in the context of §§ 2519 and 2044.) Accordingly, Donor has made a completed gift to the beneficiaries of Trust 1 in the amount of the value of the promissory notes transferred to Trust 1.

The CCA repeatedly notes the “deathbed” nature of the transaction. It is unclear if an earlier purchase would have mattered, if at such time the entire GRAT would have been included in the grantor’s estate.

R. SECTION 6166 — EXTENSION OF TIME TO PAY TAX

1. Section 6166 Election Approved. In PLR 201928007 the IRS concluded that various units of a closely-held corporation were carrying on a trade or business. The ruling states the background law as follows:

Under section 6166(a)(1), if the value of an interest in a closely held business that is included in determining the gross estate of a decedent exceeds 35 percent of the adjusted gross estate, the estate may elect to pay all or part of the tax imposed by section 2001 (the estate tax liability) in two or more (but not exceeding ten) equal installments. Under section 6166(a)(2), the maximum amount of tax that may be deferred is the percentage of estate tax equal to the percentage of the adjusted gross estate that is comprised of the closely held business amount. Under section 6166(a)(3), if the estate makes an election under section 6166(a)(1), the estate has up to five years from the due date prescribed by section 6151(a) to make the first installment payment.

Pursuant to IRC 6166(b)(1) an “interest in a closely held business” is defined, in relevant part, as: stock in a corporation carrying on a trade or business if 20% or more of the value of voting stock of the corporation is included in the gross estate, or the corporation has 45 or fewer shareholders.
Revenue Ruling 2006-34 contains a non-exclusive list of factors that are relevant in determining whether real property interests are interests in a closely held business for purposes of section 6166: the amount of time the corporation's employees devoted to the trade or business; whether an office was maintained from which the activities of the corporation were conducted and whether the corporation maintained regular business hours for that purpose; the extent to which the corporation's employees were actively involved in finding new tenants and negotiating and executing leases; the extent to which the corporation's employees provided services beyond the mere furnishing of leased premises; the extent to which the corporation's employees personally arranged for, performed, or supervised repairs and the maintenance of property (whether or not performed by independent contractors); and the extent to which the corporation's employees handled tenant repair requests and complaints. Although Revenue Ruling 2006-34 addresses interests in real estate, the factors in the revenue ruling are helpful in evaluating whether other interests are those of an active trade or business.

The ruling approves various activities as follows:

According to the facts provided, Operating Unit 2 is responsible for providing remarketing, management and support services regarding equipment owned by Operating Unit 1 and Division 1 (a division of Operating Unit 1), and equipment owned by outside lessors. Operating Unit 2 has Number 1 full-time-equivalent employees that are involved in management, support, remarketing, sale and release of the equipment. Operating Unit 2 has Number 2 locations and Number 3 off-site warehouse maintained where activities are conducted. Most lessees and customers are secured through direct activities of Operating Unit 2, and the repair of equipment is either arranged for, performed by, or supervised by an employee of Operating Unit 2.

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The facts provide that employees of Operating Unit 3 are involved in day-to-day operations, management, and maintenance of commercial class properties. Operating Unit 3 has Number 4 full-time-equivalent employees that work out of company offices in City, State. The employees of Operating Unit 3: find new tenants; negotiate and execute leases; arrange for, perform, and supervise property repairs and maintenance; and, handle tenant repair and maintenance requests, and complaints. Additionally, the employees hire and supervise independent contractors for substantial repairs and capital improvements, and services such as snow removal, landscaping, security, janitorial, and cafeteria services.

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The facts given provide that the Operating Unit 5 has Number 5 full-time equivalent non-owner employees overseeing all facets of construction and supervising operations of Company 2, an independent property management firm.

Applying Revenue Ruling 2006-34 to this situation, it appears that Company 2 is acting as an independent contractor of Operating Unit 5. The use of independent contractors to perform work does not prevent the business activities from rising to the level of the conduct of an active trade or business provided that the third-party activities do not reduce the activities of the corporation to
merely holding investment property. From the facts provided, Operating Unit 5 involves non-owner employees of Company 1 actively overseeing construction of the subject properties and actively supervising the actions of Company 2. Therefore the activities of Operating Unit 5 constitute the carrying on of a trade or business for purposes of section 6166.

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The facts presented provide that Operating Unit 6 relies on Company 3, their hotel management company, to operate and manage the subject hotel and restaurant. Operating Unit 6 has no ownership interest in Company 3. However, the facts provide that even though Company 3 operates, maintains, services, and improves the hotel, employees of Operating Unit 6 are involved in a daily basis in all aspects of the management and food service of the hotel.

Applying Revenue Ruling 2006-34 to this situation, it appears that Company 3 is acting as an independent contractor of Operating Unit 6. The use of independent contractors to perform work does not prevent the business activities from rising to the level of the conduct of an active trade or business provided that the third-party activities do not reduce the activities of the corporation to merely holding investment property. Even though Company 3 is involved in the management of the hotel, Operating Unit 6 is not merely holding an investment property. Therefore, the activities of Operating Unit 6 constitute the carrying on of a trade or business for purposes of section 6166.

S. TAX ADMINISTRATION

1. Priority Guidance Plan.

PART 1. INITIAL IMPLEMENTATION OF TAX CUTS AND JOBS ACT (TCJA)

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31. Guidance implementing changes to § 1361 regarding electing small business trusts.

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37. Regulations under § 2010 addressing the computation of the estate tax in the event of a difference between the basic exclusion amount applicable to gifts and that applicable at the donor’s date of death.

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PART 3. NEAR-TERM BURDEN REDUCTION

4. Regulations under §§ 1014(f) and 6035 regarding basis consistency between estate and person acquiring property from decedent. Proposed and temporary regulations were published on March 4, 2016.

5. Guidance under § 170(e)(3) regarding charitable contributions of inventory.
8. Final regulations under § 2642(g) describing the circumstances and procedures under which an extension of time will be granted to allocate GST exemption.

PART 5. GENERAL GUIDANCE

EMPLOYEE BENEFITS

A. Retirement Benefits

5. Regulations under § 401(a)(9) updating life expectancy and distribution tables for purposes of the required minimum distribution rules.

EXEMPT ORGANIZATIONS

4. Final regulations and other guidance under §529A on Qualified ABLE Programs as added by section 102 of the ABLE Act of 2014. Proposed regulations were published on June 22, 2015.

5. Guidance under §4941 regarding a private foundation's investment in a partnership in which disqualified persons are also partners.

6. Guidance regarding the excise taxes on donor advised funds and fund management.

GIFTS AND ESTATES AND TRUSTS

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

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

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

4. Regulations under § 7520 regarding the use of actuarial tables in valuing annuities, interests for life or terms of years, and remainder or reversionary interests. (A New Item)

INSURANCE COMPANIES AND PRODUCTS
1. Final regulations under § 72 on the exchange of property for an annuity contract. Proposed regulations were published on October 18, 2006.

TAX ACCOUNTING

5. Final regulations under § 453B regarding the nonrecognition of gain or loss on the disposition of certain installment obligations.

2. No Ruling Positions. In Rev. Proc. 2019-3 the IRS provided issues on which it will not rule. Among those are:

(34) Section 170.—Charitable. Etc., Contributions and Gifts.—Whether a charitable contribution deduction under § 170 is allowed for a transfer of an interest in a limited partnership or a limited liability company taxed as a partnership to an organization described in § 170(c).

(35) Section 170.—Charitable, Etc., Contributions and Gifts.—Whether a taxpayer who advances funds to a charitable organization and receives therefor a promissory note may deduct as contributions, in one taxable year or in each of several years, amounts forgiven by the taxpayer in each of several years by endorsement on the note.

(77) Sections 507, 664, 4941, and 4945.—Termination of Private Foundation Status; Charitable Remainder Trusts; Taxes on Self-Dealing; Taxes on Taxable Expenditures.—Issues pertaining to the tax consequences of the termination of a charitable remainder trust (as defined in § 664) before the end of the trust term as defined in the trust's governing instrument in a transaction in which the trust beneficiaries receive their actuarial shares of the value of the trust assets.

(85) Section 643(f).—Treatment of multiple trusts.—Whether two or more trusts shall be treated as one trust for purposes of subchapter J of chapter 1.

(NEW)

(88) Section 671.—Trust Income, Deductions, and Credits Attributable to Grantors and Others as Substantial Owners.—Whether the grantor will be considered the owner of any portion of a trust when (i) substantially all of the trust corpus consists or will consist of insurance policies on the life of the grantor or the grantor's spouse, (ii) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (iii) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, and (iv) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under §§ 673 to 677.

(93) Section 1001.—Determination of Amount of and Recognition of Gain or Loss.—Whether the termination of a charitable remainder trust before the end of the trust term as defined in the trust's governing instrument, in a transaction in which the trust beneficiaries receive their actuarial shares of the value of the trust assets, is treated as a sale or other disposition by the beneficiaries of their interests in the trust.
Section 2055.—Transfers for Public, Charitable, and Religious Uses.—Whether a charitable contribution deduction under § 2055 is allowed for the transfer of an interest in a limited partnership or a limited liability company taxed as a partnership to an organization described in § 2055(a).

Section 2522.—Charitable and Similar Gifts.—Whether a charitable contribution deduction under § 2522 is allowable for a transfer of an interest in a limited partnership or a limited liability company taxed as a partnership to an organization described in § 2522(a).

Section 2601.—Tax Imposed.—Whether a trust exempt from generation-skipping transfer (GST) tax under § 26.260l — l(b)(1), (2), or (3) of the Generation-Skipping Transfer Tax Regulations will retain its GST exempt status when there is a modification of a trust, change in the administration of a trust, or a distribution from a trust in a factual scenario that is similar to a factual scenario set forth in one or more of the examples contained in § 26.2601-1 (b)(4)(i)(E).

Section 4941.—Taxes on Self-Dealing.—Whether transactions during the administration of an estate or trust meet the requirements of the exception to § 4941 set forth in § 53.4941(d)-1(b)(3) of the Private Foundation Excise Tax Regulations, in cases in which a disqualified person issues a promissory note in exchange for property of an estate or trust.

In addition, rulings will “not ordinarily” be issued on the issues below. “Not ordinarily” means that unique and compelling reasons must be demonstrated in order for a ruling to be issued.

Section 170.—Charitable, Etc., Contributions and Gifts.—Whether a taxpayer who transfers property to a charitable organization and thereafter leases back all or a portion of the transferred property may deduct the fair market value of the property transferred and leased back as a charitable contribution.

Section 664.—Charitable Remainder Trusts.—Whether a trust that will calculate the unitrust amount under § 664(d)(3) qualifies as a § 664 charitable remainder trust when a grantor, a trustee, a beneficiary, or a person related or subordinate to a grantor, a trustee, or a beneficiary can control the timing of the trust's receipt of trust income from a partnership or a deferred annuity contract to take advantage of the difference between trust income under § 643(b) and income for Federal income tax purposes for the benefit of the unitrust recipient.

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

Sections 2035, 2036, 2037, 2038, and 2042.—Adjustments for Certain Gifts Made Within Three Years of Decedent's Death; Transfers with Retained Life Estate; Transfers Taking Effect at Death; Revocable Transfers; Proceeds of Life Insurance.—Whether trust assets are includible in a trust beneficiary's gross
estate under § 2035, 2036, 2037, 2038, or 2042 if the beneficiary sells property (including insurance policies) to the trust or dies within 3 years of selling such property to the trust, and (i) the beneficiary has a power to withdraw the trust property (or had such power prior to a release or modification, but retains other powers which would cause that person to be the owner if the person were the grantor), other than a power which would constitute a general power of appointment within the meaning of § 2041, (ii) the trust purchases the property with a note, and (iii) the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

(52) Section 2501.—Imposition of Tax.—Whether the sale of property (including insurance policies) to a trust by a trust beneficiary will be treated as a gift for purposes of § 2501 if (i) the beneficiary has a power to withdraw the trust property (or had such power prior to a release or modification, but retains other powers which would cause that person to be the owner if the person were the grantor), other than a power which would constitute a general power of appointment within the meaning of § 2041, (ii) the trust purchases the property with a note, and (iii) the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

(53) Section 2503.—Taxable Gifts.—Whether the transfer of property to a trust will be a gift of a present interest in property when (i) the trust corpus consists or will consist substantially of insurance policies on the life of the grantor or the grantor's spouse, (ii) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (iii) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, (iv) the trust beneficiaries have the power to withdraw, on demand, any additional transfers made to the trust, and (v) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under §§ 673 to 677.

(54) Section 2514.—Powers of Appointment.—If the beneficiaries of a trust permit a power of withdrawal to lapse, whether § 2514(e) will be applicable to each beneficiary in regard to the power when (i) the trust corpus consists or will consist substantially of insurance policies on the life of the grantor or the grantor's spouse, (ii) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (iii) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, (iv) the trust beneficiaries have the power to withdraw, on demand, any additional transfers made to the trust, and (v) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under §§ 673 to 677.

(57) Section 2601.—Tax Imposed.—Whether a trust that is exempt from the application of the generation-skipping transfer tax because it was irrevocable on September 25, 1985, will lose its exempt status if the situs of the trust is changed from the United States to a situs outside of the United States.

(58) Section 2702.—Special Valuation Rules in Case of Transfers of Interests in Trusts.—Whether annuity interests are qualified annuity interests under § 2702 if the amount of the annuity payable annually is more than 50 percent of the initial net fair market value of the property transferred to the trust, or if the value of the remainder interest is less than 10 percent of the initial net fair market value of the property transferred to the trust. For purposes of the 10 percent test,
the value of the remainder interest is the present value determined under § 7520 of the right to receive the trust corpus at the expiration of the term of the trust. The possibility that the grantor may die prior to the expiration of the specified term is not taken into account, nor is the value of any reversion retained by the grantor or the grantor's estate.

(59) Section 2702.—Special Valuation Rules in Case of Transfers of Interests in Trusts.—Whether a trust with one term holder satisfies the requirements of § 2702(a)(3)(A) and § 25.2702-5(c) to be a qualified personal residence trust.

(60) Section 2702.—Special Valuation Rules in Case of Transfers of Interests in Trusts.—Whether the sale of property (including insurance policies) to a trust by a trust beneficiary is subject to § 2702 if (i) the beneficiary has a power to withdraw the trust property (or had such power prior to a release or modification, but retains other powers which would cause that person to be the owner if the person were the grantor), other than a power which would constitute a general power of appointment within the meaning of § 2041, (ii) the trust purchases the property with a note, and (iii) the value of the assets with which the trust was funded by the grantor is nominal compared to the value of the property purchased.

Finally, rulings related to private trust companies, decanting, or the basis adjustment, if any, of assets owned by a grantor trust, will not be issued until the IRS resolves the issue through publication of a revenue ruling, revenue procedure, or regulations.

3. **Beneficiary Liability.** In United States v. Johnson, 224 F.Supp.3d 1220 (D. Utah 2016) an estate owning a hotel elected section 6166 and the hotel business subsequently became bankrupt. A key issue was whether the successor trustees of the decedent’s trust had personal liability. The opinion describes the trust as follows:

During her lifetime, Decedent and two of her children, defendants Mary Carol S. Johnson ("Johnson") and James W. Smith ("Smith"), executed a trust agreement dated February 8, 1982 for the creation of The Anna Smith Family Trust (the "Trust"), in which Decedent, Johnson and Smith were named as co-trustees. The Trust was funded on February 9, 1982 by 11,466 shares of stock in State Line Hotel, Inc. ("Hotel"). The Hotel was the holder of a Nevada gaming license. Nearly one year later, on February 1, 1990, Decedent, Johnson and Smith executed an amended trust agreement, which removed Smith and Johnson as co-trustees and left Decedent as the sole trustee of Trust.

On May 1, 1990, Decedent executed the Second Amended Trust Agreement ("Trust Agreement") as both grantor and sole trustee, which was the agreement in effect at the time of Decedent's death on September 2, 1991. It is undisputed that the Decedent had an unlimited power to modify, alter, amend, revoke, or terminate the trust at any time during her life. It is also undisputed that the Decedent, as grantor, had the right to withdraw principal and income from the Trust as she directed during her lifetime, and that no Trust beneficiaries had an enforceable right to any distributions from the Trust during Decedent's life. The Trust Agreement named Johnson and Smith as successor trustees. Johnson and Smith were also named in the Decedent's will as personal representatives of Decedent's Estate.
Section 6324 governs personal liability:

As successor trustees of the Trust, Johnson and Smith can be personally liable for unpaid estate taxes up to the value of the Trust assets under 26 U.S.C. § 6324(a)(2) only if the Trust assets were included in decedent's gross estate under 26 U.S.C. §§ 2034 to 2042, inclusive. In their motion for partial summary judgment, defendants argued that Decedent's assets were included in her Estate under 26 U.S.C. § 2033, rather than under 26 U.S.C. § 2036 or 26 U.S.C. § 2038, because the Decedent retained full beneficial ownership of all Trust assets during her lifetime and there was no transfer to any other Trust beneficiary until the time of her death. (Def.'s Mot. for Summ. J. 7, Dkt. No. 86.) By contrast, the government's motion for summary judgment on this claim argued that decedent's assets were either included in her estate under 26 U.S.C. § 2036(a) because they were transfers with a retained life estate, or under 26 U.S.C. § 2038 because the Decedent retained the power to alter, amend, revoke, or terminate the Trust. (Gov. Mot. for Summ. J. 13-19, Dkt. No. 88.) After oral argument on October 1, 2014, the court denied defendants' motion and granted summary judgment to the government on the claim that Smith and Johnson were personally liable for the unpaid estate tax as successor trustees of the Trust. (Dkt. No. 108.) The court concluded that the assets in the Trust, a fully revocable grantor trust, were included in Decedent's gross estate under 26 U.S.C. § 2036(a)(2) because as a result of the creation of the Trust and the designation of the beneficiaries therein, "at the instant of death the beneficiaries in this property had a legally enforceable interest." (Hr'g Tr. dated Oct. 1, 2014 49; Dkt. No. 113.)

Defendants have asked the court to reconsider this decision, arguing that the critical question for their claim that the Trust assets were included in the gross estate under 26 U.S.C. § 2033 is not whether the beneficiaries obtained a legally enforceable interest at the moment of Decedent's death, but rather what interest the Decedent held at the moment of her death. (Dft.'s Mot. to Reconsider 3, Dkt. No. 119.) Defendants argue that the court's analysis of 26 U.S.C. § 2036 was in error because it incorrectly focused on the interests held by the beneficiaries immediately after the moment of death, rather than on the interests held by the Decedent during her life. (Id. at 7.) From a temporal standpoint, in other words, the transfer envisioned by the fully revocable grantor trust executed by the Decedent during her lifetime only occurred as a result of Decedent's death, and thus the assets remained beneficially owned by her during her lifetime and were includable in the Estate pursuant to 26 U.S.C. § 2033 rather than § 2036 or § 2038. They further argue that this temporal analysis was not originally briefed as to section 2036, id. at 3, although the court notes that the parties did present arguments on temporal considerations as to section 2038. The government argues that the court should not reconsider defendants' motion because it merely restates the position defendants took in their initial motion. (Gov.'s Opp'n Mem., Dkt. No. 143.) Thus, the court first evaluates the legal standard required to grant a motion to reconsider.

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Here, the grantor of the Trust was the Decedent. (Dkt. No. 86-2 ¶ 1.) The Decedent was also the sole trustee of the Trust before her death, having previously exercised her right to revoke prior trust agreements that named co-trustees. (Id.) The Decedent, as grantor, had unlimited power to revoke, modify, alter, or amend the Trust at any time. (Id. at 11 ¶ 12.) It is undisputed that during the Decedent's lifetime, she did not resign as trustee or become incapacitated such that a successor trustee served in her place. The income and principal of the
Trust could be withdrawn without restriction by the Decedent only, as grantor, during her lifetime. (Id. ¶ 5A.) Only upon the grantor's death were the Trust assets to be distributed for the payment of expenses and debts and for distribution to the various beneficiaries of the Trust. (Id. ¶ 5B.)

Defendants do not dispute that Decedent's creation of the Trust changed the legal title of the Trust assets from ownership by Decedent personally to ownership by Decedent as the trustee of the Trust. While that is true, the beneficial ownership of the Trust assets never changed during Decedent's lifetime. "Actual command over the property taxed," as opposed to mere "refinements of title" are key to questions of "the actual benefit for which the [estate] tax is paid." Burnet v. Guggenheim, 288 U.S. 280, 283 (1933). Here, not only did the transfer of title to the Decedent as trustee not change Decedent's beneficial ownership of the Trust assets during her lifetime, but the beneficiaries of the Trust merely had a "hope and expectation" of inheriting a beneficial interest in the Trust assets, rather than any actual ownership interests during Decedent's lifetime. See Estate of Spruill v. Comm'r, 88 T.C. 1197, 1222 (T.C. 1987). The government's argument focused heavily on the Trust's testamentary transfer of assets to the successor trustees—rather than to Decedent's estate—at the moment of death, claiming that "[t]he language of § 2033 reaches interests in property held by a decedent at his death (i.e., his estate), not beforehand." (Gov. Opp'n Memo 22, Dkt. No. 88.) Upon reconsideration, however, the court concludes that unless Decedent transferred beneficial ownership of Trust assets during her lifetime, how or to whom they transferred upon her death—no matter how "instantaneous"—simply plays no part in the section 2033 analysis. (Gov. Reply 4-7, Dkt. No. 98.) See 26 C.F.R. 20.2033-1.

On January 8, 2018, the District Court awarded $316,206.06 in attorney’s fees and costs against the government on account of positions lacking substantial justification. United States V. Johnson, et. al., 2018 WL 327245.

The Tenth Circuit reversed at United States v. Johnson, 920 F. 3d. 639 (10th Cir. 2019). The opinion states:

The sole question before this court is whether the six-year statute of limitations set out in Utah Code Ann. § 78B-2-309(2) or the ten-year statute of limitations set out in 26 U.S.C. § 6502(a) is applicable to the Government’s third party-beneficiary claim. The Supreme Court has previously stated that “[w]hether in general a state-law action brought by the United States is subject to a federal or state statute of limitations is a difficult question.” United States v. California, 507 U.S. 746, 758 (1993). Here, however, Supreme Court and Tenth Circuit precedent dictates the result advocated by the Government.

In United States v. Summerlin, the Supreme Court held that “the United States is not bound by state statutes of limitation . . . in enforcing its rights,” even if the suit is brought in state court. 310 U.S. 414, 416 (1940). The Court summarized the generally applicable rule as follows: “When the United States becomes entitled to a claim, acting in its governmental capacity and asserts its claim in that right, it cannot be deemed to have abdicated its governmental authority so as to become subject to a state statute putting a time limit upon enforcement.” Id. at 417. In United States v. Holmes, this court applied Summerlin to the question of whether the ten-year limitations period set out in § 6502(a) governed the Government’s attempt to collect corporate taxes from the corporation’s sole shareholder, defendant Holmes. 727 F.3d 1230, 1232 (10th Cir. 2013). The taxes were assessed against the corporation but were unpaid at the time the
corporation wound up its operations and made distributions to Holmes. Id. at 1231. The Government filed suit against Holmes, raising only state-law claims. Id. at 1232. Holmes argued the Government’s claims were subject to a two-year state statute of limitations. Id. at 1233. This court ruled otherwise, concluding the Government’s claims were “in every real sense a proceeding in court to collect a tax” and, thus, the Government was “acting in its sovereign capacity in an effort to enforce rights ultimately grounded on federal law.” Id. at 1235 (quotation omitted). Appellees argue that Holmes is distinguishable from this matter because the shareholder’s liability in that case was based on transferee liability, not a contract as it is here. This factual difference is not material.

Holmes clearly stands for the proposition that the Government is always acting in its sovereign capacity when it seeks to collect unpaid federal taxes. It is immaterial whether its claim to payment arises under federal or state statutory or common law. The only relevant question is whether the Government’s suit, if successful, will result in the defendant’s liability to pay federal taxes the Government has assessed against a taxpayer. If so, then the federal statute of limitations applies. Appellees’ attempts to distinguish the facts in Holmes are unpersuasive. Because the Government’s third-party-beneficiary claim seeks to hold Appellees liable for the payment of unpaid estate taxes assessed against the Estate, § 6502(a) supplies the statute of limitations applicable to the Government’s claim.

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Under § 6324(a)(2), a person who holds or receives property included in a decedent’s gross estate is personally liable for the estate tax to the extent of the date-of-death value of the property received. Appellees do not dispute that they are transferees under § 6324(a)(2) because they received life insurance proceeds includible in the Decedent’s estate. The sole dispute between the parties centers on whether the Government’s § 6324(a)(2) claim was timely filed.

The Government generally has ten years to collect estate taxes from a decedent’s estate, either “by levy or by a proceeding in court.” 26 U.S.C. § 6502(a)(1). Here, the ten-year limitations period was suspended pursuant to 26 U.S.C. § 6503(d) because the Estate made a deferment election pursuant to 26 U.S.C. § 6166. The parties agree the Estate was timely assessed on July 13, 1992, and the § 6166 election terminated on December 15, 2003, when the Estate failed to make an installment payment. See 26 U.S.C. § 6166(g)(3). The Government filed suit on January 21, 2011, raising the § 6324(a)(2) claim in its complaint.

Appellees argue § 6503 does not suspend the statute of limitations for § 6324(a)(2) transferees even if a valid § 6166 election suspends the limitations period for the estate. Instead, they argue, the limitations period set out in § 6901(a) governs transferee liability. Section 6901(a) provides that an assessment against a transferee shall be made within one “year after the expiration of the period of limitation for assessment against the transferor.” 26 U.S.C. § 6901(c). Appellees argue the Government never timely and properly assessed them by following the procedure set out in § 6901(a). It is well-settled, however, that § 6901 sets out an alternative collection procedure applicable to transferees who receive property from a decedent’s estate. United States v. Russell (Russell I), 461 F.2d 605, 606 (10th Cir. 1972). Section 6901 is inapplicable in this matter because the Government chose to bring its transferee-liability claim pursuant to § 6324(a)(2). Holmes, 727 F.3d at 1234 (“The collection procedures contained in § 6901 are not exclusive and mandatory, but are cumulative and alternative to the other methods of tax collection recognized and used prior to the enactment
of § 6901 and its statutory predecessors.” (quoting Russell I, 461 F.2d at 606); see also United States v. Geniviva, 16 F.3d 522, 524 (3d Cir. 1994) (relying on the reasoning in Russell I to hold “that an individual assessment under 26 U.S.C. § 6901 is not a prerequisite to an action to impose transferee liability under 26 U.S.C. § 6324(a)(2)”).

Appellees argue our settled precedent in Holmes and Russell I does not control the outcome in this matter because the Estate made a § 6166(a) election and, thus, the Government is required to follow the assessment procedures set out in § 6901. Appellees’ reasoning as to why the Government must proceed under § 6901 when an estate makes a § 6166(a) election is less than clear. But, regardless of its specifics, Appellees’ extensive argument centering on § 6901 cannot be reconciled with this court’s holding in United States v. Botefuhr, 309 F.3d 1263 (10th Cir. 2002).

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In Botefuhr, this court made it very clear that the limitations period applicable to a decedent’s estate also governs the limitations period applicable to transferees. 309 F.3d at 1277. The references in § 6503(d) to “any tax imposed by chapter 11” has no impact on that holding. Rather, § 6503(d) is relevant in the analysis only to the extent it determines the statute of limitations applicable to the estate. And, once the limitations period for the estate is determined, Botefuhr unambiguously holds that a § 6324 claim can be brought against a transferee within that same period. Id. Appellees’ argument that § 6503(d) does not “extend the limitations period for transferees” ignores Botefuhr’s definitive holding that the limitations period for transferees is the same as the limitations period for the estate. 10 Here, Appellees concede the Government filed its § 6324(a)(2) claim before the statute of limitations ran against the Estate. Thus, the Government’s claim is timely.

Accordingly, the award of attorney’s fees was reversed too. The taxpayer filed a petition for a Writ of Certiorari as James W. Smith v. United States.

4. Defective Gift-Split and GST. An erroneous 709 was the subject of PLR 201811002. There husband funded four trusts and he, with his wife, filed gift tax returns splitting gifts. However, his return showed the split as three-fourths of the contribution and hers showed one-fourth. Neither allocated any GST exemption. The ruling concludes:

Under § 2513, Husband’s Year 1 transfers to Trusts, totaling $r, are considered as made one-half by Husband and one-half by Wife. However, under § 2504(c) and § 25.2504-2(b), because the time has expired under § 6501 within which a gift tax may be assessed, the amount of the taxable gift is the amount that is finally determined for gift tax purposes and may not thereafter be adjusted. In this case, the disproportionate gift split reported on Husband’s and Wife’s respective Forms 709 represents the amounts that are finally determined for gift tax purposes.

Consequently, for gift tax purposes, Husband is treated as transferring $s to Trusts on Date 1, and Wife is treated as transferring $q to Trusts on Date 1.

However, under § 26.2652-1(a)(4) of the Generation-Skipping Transfer Tax Regulations, Husband is regarded for GST tax purposes as the transferor of one-
of the total value of the property transferred to Trusts on Date 1, which is equal to $u, regardless of the interest Husband is treated as transferring under § 2513 for gift tax purposes. Accordingly, Husband’s late allocation of GST exemption to Trusts on the Year 2 Form 709 is effective only to the one-half portion of the property transferred to Trusts, of which he is considered the transferor for GST tax purposes. See § 2631(a); § 26.2632-1(b)(4)(i) (an allocation of GST exemption to a trust is void to the extent the amount allocated exceeds the amount necessary to obtain an inclusion ratio of zero).

In PLR 201811003, wife was allowed to allocate her GST exemption late.

5. **Trust Modifications Approved Without Tax Consequences.** PLR 201814005 approved a series of extensive trust changes pursuant to court order. The ruling described the changes as follows:

The petition seeks to modify the terms of Trust (Reformed Trust) as follows: (1) convert Grandchild’s mandatory income distribution beginning at age 21 to a discretionary distribution of income standard; (2) provide that the Trustee will set aside any income not distributed to Grandchild beginning at the age of 21 years in a separate account and distribute the entire amount remaining in such separate account to Grandchild’s estate at the death of Grandchild; (3) remove Grandchild’s unilateral right to withdraw up to one-half of the value of the Trust principal after reaching the age of 25 years but prior to reaching age 30 years; (4) grant Grandchild a testamentary general power of appointment to appoint up to one-half the value of Trust principal to the creditors of Grandchild’s estate if Grandchild dies after reaching the age of 25 years but prior to reaching age 30 years; (5) remove Grandchild’s unilateral right to withdraw up to the entire value of the Trust principal after reaching the age of 30 years; and (6) grant Grandchild a testamentary general power of appointment to appoint up to the entire value of the Trust principal after reaching the age of 30 years.

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The petition also seeks to modify Child 3’s contingent remainder interest in Trust from being held in a trust under the same terms that would apply to Child 1, to being held in a separate special needs trust for Child 3’s primary benefit to allow Child 3 to qualify for government and private benefits.

Specifically, Article IV of Reformed Trust provides:

Subject to the restrictions in subsections 1 through 3 below, during the life of [Child 3], the Trustee may, at any time and from time to time, pay to, or apply for the benefit of [Child 3], so much, if any, of the income and principal of the trust as the Trustee, in the Trustee’s sole discretion, deems necessary to provide for those needs of [Child 3] that are not satisfied through any government or private program of financial entitlements, services, or other benefits. All distributions from the trust shall be paid directly to the provider of the services and not directly to [Child 3]. Any income not distributed shall be added to the principal of the trust. No part of the principal or undistributed income of the trust shall be considered available to [Child 3].

The petition also seeks to change the distribution of the Trust assets upon the death of Child 3 to provide that “the remaining undistributed income and
principal of [the special needs trust for the benefit of Child 3] shall be distributed outright and free of trust to Foundation.”

The ruling notes the following about Grandchild and Child 3:

Child 1 was survived by one child, Grandchild. Grandchild’s mother is also deceased. Grandchild recently attained 18 years of age and until Grandchild’s 18th birthday, Child 4 served as guardian of the person and property of Grandchild. Grandchild has no descendants. Grandchild was diagnosed with a medical condition which makes Grandchild not capable of managing specific financial matters, such as managing money, budgeting, or tracking expenses, without assistance.

Child 3 is an incapacitated adult and is a resident at a medical facility. Grantor and Child 4 serve as the guardians of the person and property of Child 3. Child 3 has no descendants.

The IRS granted the requested rulings:

1. The modification of the terms of Trust will not cause Trust’s inclusion ratio to change and will not adversely affect the exemption of Trust from GST tax.

2. The modification of the terms of Trust will not cause any beneficiary of Trust to have made a gift for gift tax purposes under § 2501.

3. The modification of the terms of Trust will not cause any beneficiary of Trust to recognize gain or loss from the sale or disposition of property under § 61 or 1001.

In PLR 201919002 a trust was modified so that it could own life insurance without inclusion the insured’s estate. The ruling provides:

In Year 1, Trustee proposed to purchase a life insurance policy on the joint lives of Child 1 and Spouse. However, Section 6.1 of Trust provides Child 1 with a testamentary special power of appointment over all assets contained in Trust. As a result, if Trust owned a life insurance policy on the life of Child 1, there is a risk that the life insurance death benefit proceeds will be included in Child 1's gross estate for federal estate tax purposes upon Child 1's death.

Accordingly, Child 1, in the capacity of Trustee of Trust, petitioned Court to modify the terms of Trust to remove Child 1's testamentary special power of appointment over any life insurance policy on Child 1's life or the proceeds of such policy; to add an Insurance Trustee, who will have sole authority over any insurance policies on the life of Child 1 purchased by Trust; and to modify Trust to require that premium payments on life insurance policies on Child 1 must be paid out of Trust corpus. On Date 2, in Year 1, a Final Judgment of Modification was issued by Court approving the modification of Trust.

Pursuant to the Final Judgment of Modification, Trust is modified as follows:

Section 2.5, as modified, provides that if Trust owns any life insurance on the life of Settlor, a beneficiary, or a trustee, premium payments shall only be made out of corpus, and not out of income (as determined for federal income tax
purposes under Subpart E of Part I, Subchapter J, Chapter 1, Subtitle A of the Internal Revenue Code (Code)).

Sections 6.1, 6.2 and 6.3, as modified, provide that a holder of a testamentary special power of appointment under the terms of Trust, Child's Trust or Descendant's Trust is excluded from exercising the power over any life insurance policy on such beneficiary's life or proceeds of such policy on such beneficiary's life.

Section 7.12(a) of Trust, as modified, is deleted and replaced with the following:

Notwithstanding the foregoing procedure, [Child 2] is appointed as Insurance Trustee (hereinafter referred to as “Insurance Trustee”) if a trust governed by this Agreement intends to purchase, purchases, owns or otherwise possesses any incidents of ownership over any life insurance policies on the life of the primary Trustee within the meaning of § 2042 of the Internal Revenue Code. [Child 1] shall have the power to: (i) change the Insurance Trustee succession herein, (ii) appoint one or more persons, individual or corporate, excluding [Child 1], to serve as Insurance Trustee or Co-Trustees of this trust or any trust created hereunder, and (iii) remove such persons appointed, whether now serving or appointed to serve in the future. Provided, however, [Child 1] shall not have the power to appoint a person related to or subordinate to [Child 1], within the meaning of § 672(c) of the Internal Revenue Code, as successor Insurance Trustee. The Insurance Trustee shall have the power to maintain the policies in which the applicable trust has an ownership interest and pay the trust's proportionate share of the premiums thereon. If for any reason there are not sufficient funds to pay the premiums and maintain the policies in force, the Insurance Trustee shall have authority to accept paid-up insurance for the policies. Additionally, if necessary for the health, support or maintenance of the beneficiary of that trust, the Insurance Trustee shall have complete authority to surrender the said policies, or borrow on them, and to utilize the proceeds for the benefit of that trust beneficiary. The Insurance Trustee shall not be liable to any beneficiary by virtue of its decision in exercising its discretion and in carrying out these instructions. If [Child 2] should die, resign or be unable or unwilling to exercise the power described in this subparagraph, unless [Child 1] has otherwise named a successor Insurance Trustee, then a majority of the beneficiaries then entitled or permitted to receive income from each separate trust hereunder, per stirpes and not per capita, who are at least twenty-one (21) years of age, shall have the authority to appoint a successor Insurance Trustee, other than Settlor.

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In the present case, prior to the modifications of Trust, Section 2.1 of Trust expressly granted the Trustee the power to own and acquire life insurance and to pay the premiums on existing life insurance on the life of any person in which the trust or its beneficiaries may have an insurable interest. The ownership of any and all policies of insurance applied for and purchased by the Trustee or transferred and assigned to the Trustee is irrevocably vested in the Trustee. Under Section 2.4, Child 1, as the Trustee, is vested with all rights, powers, options, elections, privileges and incidents of ownership in all insurance policies owned by Trust. Accordingly, prior to the modifications, Child 1 possessed all incidents of ownership in any life insurance policy on Child 1's life that the Trust may acquire.
The modifications to Trust relinquished Trustee's powers with respect to any life insurance policy on Child 1's life acquired by Trust and granted such powers to an Insurance Trustee. Under Section 7.12(a), as modified, Child 2 is appointed as Insurance Trustee with power to maintain and pay premiums on a life insurance policy on the life of Child 1. Child 2 shall have complete authority to surrender policies, borrow on them, or utilize the proceeds for the benefit of the beneficiary if necessary for the health, support or maintenance of the beneficiary. Accordingly, Trustee is precluded from exercising any power normally conferred on the owner of a policy.

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Further, prior to the modifications of Trust, Child 1 possessed a testamentary special power of appointment over the Trust principal, which would include any proceeds from life insurance on the life of Child 1 that Trust may hold. This power gave Child 1 the power to change the beneficial ownership of the proceeds. However, the modifications to Trust restrict Child 1's testamentary special power of appointment. Under Section 6.1, as modified, Child 1 may not exercise Child 1's testamentary special power of appointment over any life insurance policies on the life of Child 1. Accordingly, Child 1 may not exercise Child 1's testamentary special power of appointment to change the beneficial interests in the proceeds of the life insurance policy on Child 1's life.

In this case, Child 1's powers, in the capacity as Trustee and beneficiary were eliminated prior to the acquisition of the life insurance policy on Child 1's life. Trust is the owner and beneficiary of the policy. Accordingly, when the Insurance Trustee purchased a life insurance policy on Child 1's life, Child 1 did not possess and did not have the power to exercise, any incidents of ownership in the policy acquired by Trust. Child 1 will not relinquish or transfer any incidents of ownership in the policy as a result of the modification prior to the acquisition of the policy.

6. **Effectiveness of Wandry-Like Defined Value Clause.** Significant gifts were alleged by the IRS in cases involving the True family, at *Karen S. True v. Commissioner*, Tax Court Docket No. 21896-16, and *H.A. True III v. Commissioner*, Tax Court Docket No. 21897-16 (petitions filed October 11, 2016). The gifts were made with adjustment clauses that moved amounts in excess of the stipulated (and desired) gift of about $34,000,000 into sales with the “donee” children owing none on a note. The IRS argued that the gifts were about $95 million more than the $34 million number. The cases settled for an additional $4 million in gift tax (and an unknown amount, if any, note adjustment).

7. **Gift Tax Protective Refund Claims Allowed.** CCA 201906006 notes that a protective refund claim for gift taxes may be made. There is no indication of a situation where such would be helpful but it is good to know.

8. **Alleged Failure to Advise About Basis.** A complaint styled *Raia v. Lowenstein Sandler* has been filed in the Superior Court of New Jersey Law Division: Civil Part, Bergen County (BER-L-000921-19). The essence of the action is the supposed failure of counsel to advise clients that assets given to dynasty trusts retain carryover basis and potential particular problems that could result from depreciation recapture upon the trusts.
ceasing to be grantor trusts when the grantor died. Regardless of the merits – if any – of the action, it is a reminder
for estate planners.

9. **Date of Assessment for Section 6502 Purposes.** United States v. Estate of Albert Chicorel, 907 F.3d 896 (6th Cir. 2018), held that the filing of a proof of claim counts as the date of assessment for section 6502
purposes. The opinion states:

At the heart of this dispute is the statute of limitations in 26 U.S.C. § 6502(a), which provides that, after the government assesses a tax, “such tax may be collected by levy or by a proceeding in court, but only if the levy is made or the proceeding begun—(1) within 10 years after the assessment of the tax.” 26

The government contends that it satisfied the statute by filing its proof of claim
in Chicorel’s probate proceeding. The government’s case rests on two
propositions: first, that the proof of claim is a proceeding in court for purposes
of § 6502(a); and second, that any timely filed proceeding in court satisfies the
statute of limitations, meaning that additional proceedings can be filed anytime
thereafter.

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The nature, function, and effect of a proof of claim in Michigan has significant
legal consequences for the creditor, the estate, and for Michigan law generally.
For these reasons, it qualifies as a proceeding in court under § 6502(a). The
Michigan probate code states that “[f]or purposes of a statute of limitations, the
proper presentation of a claim ... is equivalent to commencement of a
proceeding on the claim.” Mich. Comp. Laws § 700.3802(3). Not only does
Michigan law permit a proof of claim to toll state statutes of limitations, it
specifically equates presentation of the claim with a proceeding. Also relevant is
that a properly presented proof of claim necessarily requires action on the part of
the estate. The submission of a proof of claim requires the estate to provide
notice that the claim is not allowed, otherwise the claim is deemed automatically
allowed. Id. § 700.3806(2). By filing the proof of claim, the creditor puts the
claim on the path towards final disposition.

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Having determined that the proof of claim qualifies as a proceeding in court, we
turn to the second issue: whether the timely filed proof of claim satisfied the
statute of limitations for this action. We hold that the statute of limitations in §
6502(a) is satisfied once the government commences any timely proceeding in
court. We have previously noted that the government can collect on judgments
arising out of timely proceedings even more than ten years after the assessment.
See United States v. Weintraub, 613 F.2d 612, 620–21 (6th Cir. 1979) (“[T]here
is no time limit whatsoever on an action against the taxpayer to enforce a timely
levy or judgment obtained in a timely filed court proceeding.”).

10. **Income Tax Transferee Liability.** An interesting income tax transferee liability arose in
Hawk v. Commissioner, 924 F.3d 821 (6th Cir. 2019). The opinion summarizes the facts:
After Billy Hawk died in 2000, his wife Nancy Sue decided to sell the family bowling business, Holiday Bowl. With the help of lawyers and accountants, she made a deal with MidCoast, a company that claimed an interest in acquiring companies with corporate tax liabilities that it could set off against its net-operating losses. Holiday Bowl first sold its assets—bowling alleys—to Bowl New England, receiving $4.2 million in cash and generating about $1 million in federal taxes. After that, Nancy Sue and Billy’s estate sold Holiday Bowl to MidCoast for about $3.4 million, in essence exchanging one pile of cash for another minus the tax debt MidCoast agreed to pay. But MidCoast never paid the taxes. The United States filed this transferee-liability action against Nancy Sue Hawk and Billy Hawk’s estate to recover Holiday Bowl’s unpaid taxes. The Tax Court ruled for the government, concluding that the Hawks were transferees of a delinquent taxpayer under federal law and permitting the government to recover the unpaid taxes from the Hawks under Tennessee law. We affirm.

The court found it helpful to illustrate the general scheme of section 6901, which allows the federal government to have the status of a private creditor pursuing the transferee in federal court. The opinion provides two examples:

Two examples illustrate what § 6901 is getting at. Imagine Company A. It has $5 million in assets that have a basis (cost) of $1 million. Let’s say Company A sells its assets (a manufacturing plant) to Company B for cash. At that point, Company A would owe federal taxes on the $4 million gain generated by the sale. But suppose that Company A’s owners decide not to pay Company A’s taxes. They instead pay themselves $5 million and simply let Company A go belly-up, leaving Company A’s taxes unpaid. That leaves a classic transferee liability for the owners under § 6901.

What happens, however, if the owners try to avoid that liability with an intermediary transaction? The owners sell Company A to a foreign Company C for $5 million—the exact amount of money that Company A has in the bank. This leaves the owners with $5 million, and Company C with $5 million in Company A, and Company A still needing to pay its taxes. Because Company C is outside the United States, the government might not be able to pursue Company C as a transferee when it empties Company A’s coffers and no one pays A’s taxes. In this setting, a court might decide that the sale of Company A had no economic substance to it, and that the owners really transferred Company A’s cash directly to themselves.

So, which scenario might apply here? The transaction at issue was described as follows:

After Billy Hawk’s death in 2000, Nancy Sue owned almost a fifth of the company’s stock and her husband’s estate owned the remainder. Billy and Nancy Sue’s two sons operated the two bowling alleys awhile. But that didn’t work. By 2002, she realized she needed to sell Holiday Bowl. She chose an asset sale to Bowl New England. The sale left Holiday Bowl with $4.2 million in cash and left the company owing about $1 million in federal income taxes and about $200,000 in state taxes. Holiday Bowl also owned some real property, a family horse farm that Nancy Sue wanted to keep, valued at $777,000.

Trying to lower the corporate taxes triggered by the transaction, the Hawks’ broker approached their attorney with information about a company called MidCoast that had “tremendous tax-loss carry-forwards.” J.A. 3 at 797. If MidCoast bought Holiday Bowl, the broker advertised, Holiday Bowl would not
need to pay corporate taxes on the asset sale. As a result, MidCoast promised to pay the Hawks more than Holiday Bowl’s actual value—what would have been its cash on hand minus outstanding taxes. Nancy Sue Hawk and the estate stood to keep an extra $200,000 to $300,000 by structuring the transaction in this way. MidCoast purported to offer Holiday Bowl a way to realize the best attributes of an asset sale (the higher sale price of the assets) and a stock sale (no corporate-level tax). In closing his recommendation, the broker, warily but not warily enough, said: “[I]f it seems too good to be true, it probably is. But maybe this is the exception.” Id. at 798.

The Hawks proceeded to enjoy what looked like a free lunch. Under the purchase agreement, the Hawks sold Holiday Bowl some of their shares in exchange for the company’s remaining property, the horse farm. That left Holiday Bowl with nothing but cash. MidCoast paid $3.4 million plus expenses for Holiday Bowl’s $4.2 million. To finance the transaction, MidCoast claimed it would borrow money from a company called Sequoia Capital. According to MidCoast, Holiday Bowl would then enter the debt-collection business, rapidly generating new losses that would offset Holiday Bowl’s existing taxes.

After the sale, MidCoast transferred Holiday Bowl to Sequoia in exchange for the cancellation of Sequoia’s loan and about $320,000 in cash. No one ever paid Holiday Bowl’s outstanding taxes, and the one-time bowling company dissolved in 2006.

The Internal Revenue Service investigated MidCoast, uncovering the Holiday Bowl sale and about sixty similar transactions. That did not end well for MidCoast, Sequoia, and a law firm, as a grand jury indicted several individuals associated with each of them. One defendant pleaded guilty. Others fled the country. The government launched a civil collection proceeding against the Hawks in pursuit of Holiday Bowl’s unpaid taxes. The Tax Court concluded that Sequoia’s loan to MidCoast was a sham and that Holiday Bowl had simply distributed cash to the Hawks, who were liable to the government as Holiday Bowl’s fraudulent transferees. This appeal followed.

At issue was the “reality” of the transaction. The government’s position was that in essence the Harks got Holiday Bowl’s money. The court agreed:

The Tax Court permissibly refused to respect several features of the form that MidCoast and the Hawks tried to place on this transaction. Start with the ostensibly independent financing of it: the Sequoia loan. The Tax Court found that the Hawks didn’t even get Sequoia’s (ostensibly) loaned funds. They got Holiday Bowl’s own funds, which were wired into an escrow account and promptly funneled back from the same escrow account to the Hawks. The quintessential explanation for refusing to respect the form of a transaction is that it amounts to a charade. What purported to be real, a Sequoia loan to MidCoast to finance the sale, was not in fact real, as MidCoast paid for the transaction with Holiday Bowl funds.

Even aside from tracing where the dollars and cents came from and where they eventually went, the Sequoia loan looked like an impostor on paper. Under the terms of the deal, Sequoia had no risk because Holiday Bowl’s own cash served as the collateral for the loan. The idea was that lenders traditionally require security for a loan. And this loan looked like it had security. But an immediately repayable, cash-for-cash loan backed up by cash is not a traditional loan. Money is fungible. So is air. By getting a “loan” from Sequoia, MidCoast could access
cash, which it then could immediately pay back with Holiday Bowl’s own money—in effect using Holiday Bowl’s bank account at no risk to Sequoia. In this setting, the security was no security at all.

It gets worse. The parties didn’t sign most of the loan documents, behavior that does not accord with the way people usually transfer large pots of money. Interest and periodic payments are a classic hallmark of real loans. See Roth Steel Tube Co. v. Comm’r, 800 F.2d 625, 631 (6th Cir. 1986). But Sequoia’s loan wouldn’t incur interest unless MidCoast defaulted. While Sequoia did stand to make about $17,250 when MidCoast paid back the loan, this translated to annual interest of $6.3 million, nearly double what MidCoast borrowed. At dusk’s end, Holiday Bowl distributed its money to the Hawks, in substance if not always in form, making them the company’s transferees.

The problem by the way is not that the Hawks were trying to lower their taxes. No American to our knowledge prefers a higher tax bill. There are other ways to express fealty to our country. The problem is that the transaction lacked economic substance; it was nothing but misleading labels and distracting forms—trompe l’oeil from start to finish.

There was a final step. Under Tennessee law, could the government, as a creditor, collect? The Sixth Circuit held that it could:

First, for many of the same reasons the Holiday Bowl transaction amounts to a transfer to the Hawks under federal law, it counts as a transfer from Holiday Bowl to the Hawks under Tennessee law. Tennessee law defines a transfer broadly to include “every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with an asset or an interest in an asset, and includes payment of money, release, lease, and creation of a lien or other encumbrance.” Id. § 66-3-302(12). Apt is the word “indirect.” Even if the Hawks received Sequoia’s money (which they didn’t), the Hawks still would have received Holiday Bowl’s funds indirectly.

Tennessee courts also consider the economic substance of the Holiday Bowl transaction. The Uniform Fraudulent Transfer Act incorporates traditional “principles of ... equity.” Id. § 66-3-311. And Tennessee courts have long relied on sham-transaction principles in settings like this one. See, e.g., CAO Holdings, Inc. v. Trost, 333 S.W.3d 73, 88 (Tenn. 2010); M. & M. Stamp Co. v. Harris, 212 Tenn. 158, 368 S.W.2d 752, 755 (1963). The Tennessee statute also directs that it “shall be applied and construed to effectuate its general purpose to make uniform the law with respect to the subject of this [statute] among states enacting it.” Tenn. Code Ann. § 66-3-312. And other courts have held that the sham-transaction principles apply to other States’ Uniform Fraudulent Transfer Acts. See, e.g., Feldman, 779 F.3d at 459 (interpreting the Wisconsin statute); In re AFI Holding, Inc., 525 F.3d 700, 708 (9th Cir. 2008) (interpreting the California statute).

Second, Holiday Bowl didn’t receive reasonably equivalent value for the horse farm or the cash that the company transferred to the Hawks. The Act defines value as “property” transferred or “an antecedent debt ... secured.” Tenn. Code Ann. § 66-3-304(a). When the Hawks exchanged stock for the horse farm, the transaction merely subtracted from Holiday Bowl’s balance sheet. And Holiday Bowl got nothing when the Hawks received their $3.4 million.
Third, Holiday Bowl also became *insolvent* due to this transaction. After the Hawks received their cash back, Holiday Bowl had only about two-thirds of the money that it needed to pay its outstanding taxes.

The court ends with an interesting philosophical flourish:

For those readers still with us, you might wonder: Was there a way to make this tax-reduction strategy work? Was it ever possible for MidCoast to offset Holiday Bowl’s taxes with net operating losses, say by making the Sequoia loan a kosher one and dotting another “i” and crossing another “t” in the underlying transactions? The answer is “maybe” in the abstract and “not likely” here.

As one treatise puts it, “Congress, with assistance from the courts, has constructed a formidable defense against taxpayer efforts to traffic in net operating losses and other corporate tax benefits.” Boris I. Bittker & James S. Eustice, *Federal Income Taxation of Corporations and Shareholders* § 14.02 (7th ed. 2019). The Internal Revenue Code prevents a company with pre-existing losses from purchasing a company with pre-existing gains and canceling the two out within five years of the sale. See 26 U.S.C. § 384; Bittker & Eustice, *supra*, § 14.45.

That’s why MidCoast told the Hawks that it would operate Holiday Bowl as a debt-collection business and generate new losses within Holiday Bowl—a different strategy from the one the broker originally proposed. For this scheme to eliminate Holiday Bowl’s 2003 taxes, it appears, the new losses needed to arise between the November 2003 sale and the end of the year. After hearing the evidence, the Tax Court concluded that “[i]t was not plausible” that a MidCoast-owned Holiday Bowl could ever incur the necessary “offsetting expenses” in time. J.A. 3 at 481.

That reality and others too separate this case from *Summa Holdings, Inc. v. Commissioner*, 848 F.3d 779 (6th Cir. 2017). Those taxpayers sought to take advantage of two investment vehicles—a “domestic international sales corporation” and a Roth IRA. The former allows an exporter to shelter certain income from corporate tax. *Id.* at 782. The latter allows individuals to save limited amounts tax free. *Id.* at 783. Done together, a Roth IRA owning shares in a domestic international sales corporation permits taxpayers to transfer (and potentially grow) many assets in their Roth IRAs and spare themselves considerable taxes. *Id.*

That’s exactly what the *Summa Holdings* taxpayers did. Citing the substance-over-form doctrine, however, the Commissioner claimed authority to ignore the form of the legislatively approved transactions. We disagreed because “[t]he Internal Revenue Code allowed” the taxpayers “to do what they did.” *Id.* at 784. Courts (and agencies) must respect a statute’s text, and the Commissioner’s revision took the substance-over-form doctrine a “step too far.” *Id.* at 785. The Commissioner, we acknowledged, may “honor the fiscal realities of what taxpayers have done over the form in which they have done it.” *Id.* But neither the Commissioner in particular nor the Executive Branch in general may rewrite “the meaning of statutes” whenever it dislikes the law. *Id.*

Think about it. Everyone in *Summa Holdings* agreed that the plain terms of the relevant statutes permitted the transaction. *Id.* at 784. Not even *Chevron* permits government agencies to ignore the plain text of a statute. *Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 842–43, 104 S.Ct. 2778, 81
L.Ed.2d 694 (1984). What, then, made the Internal Revenue Service think it could ignore the plain text of a statute—one that other agencies could not override under Chevron—under the substance-over-form doctrine? This version of the doctrine makes Chevron look like a modest assumption of executive power. When all was said and done, Summa Holdings was a case in which the taxpayers forced the government to play it straight—to make it respect the form and substance of the laws Congress wrote.

That leaves two sides to the substance and form coin. On one side is Summa Holdings. If Congress authorizes taxpayers to do something—in Summa Holdings, employing Code-compliant “shell corporations . . . that have no economic substance”—the Commissioner can’t override the constitutional forces of bicameralism and presentment. Summa Holdings, 898 F.3d at 786. On the other side is the Hawks’ case. The government isn’t seeking to ignore the form of the Code today. It’s enforcing the statutes as written. No one disputes that Holiday Bowl owed taxes that the Code imposes. The Code places substantial limits on even the above-board version of this transaction, limits that foreclosed MidCoast’s ability to offset Holiday Bowl’s pre-existing gains. What’s more, § 6901 provides a mechanism for the government to pursue a delinquent taxpayer’s assets in cases just like this one. Tennessee law seeks a similar end. All in all, the Commissioner isn’t disregarding statutory text in the name of economic substance; he’s honoring the written word and the economic realities of this transaction.

We affirm.

11. Section 9100 Relief Allowed For Late Section 663(b) Election. Section 663(b) allows estate or trust distributions within 65 days after the end of the estate, or trust’s taxable year to “count” as having been made on the last day of the taxable year. An election is required on the applicable form 1041. What if the election is not made or is late? PLR 201928010 states:

Section 1.663(b)-2(a)(1) of the Income Tax Regulations provides that if a trust return is required to be filed for the taxable year of the trust for which the election is made, the election shall be made in the appropriate place on such return. The election under § 1.663(b)-2(a)(1) shall be made not later than the time prescribed by law for filing such return (including extensions thereof). Such election shall become irrevocable after the last day prescribed for making it.

Section 301.9100-1(c) provides that the Commissioner may grant a reasonable extension of time under the rules set forth in §§ 301.9100-2 and 301.9100-3 to make a regulatory election, or a statutory election (but not more than 6 months except in the case of a taxpayer who is abroad), under all subtitles of the Code except subtitles E, G, H, and I. Section 301.9100-1(b) provides that the term “regulatory election” includes an election whose due date is prescribed by a regulation published in the Federal Register.

Section 301.9100-2 provides the rules governing automatic extensions of time for making certain elections. Section 301.9100-3 provides the standards the Commissioner will use to determine whether to grant an extension of time for regulatory elections that do not meet the requirements of § 301.9100-2.

Section 301.9100-3(a) provides that requests for relief subject to § 301.9100-3 will be granted when the taxpayer provides the evidence (including affidavits
described in § 301.9100-3(e)) to establish to the satisfaction of the Commissioner that (1) the taxpayer acted reasonably and in good faith, and (2) the grant of relief will not prejudice the interests of the Government.

Conclusion

Based solely on the facts submitted and representations made, we conclude that Estate has satisfied the requirements of §§ 301.9100-1 and 301.9100-3. As a result, Estate is granted an extension of time of 120 days from the date of this letter to file an election under § 663(b). The election should be made by filing an income tax return for the year ending on Date 2, amended to include the election, with the appropriate service center. A copy of this letter should be attached to the amended return.

T. MISCELLANEOUS

1. **Decanting.** The ability of a trustee to distribute assets to a new trust having the same, or essentially the same, beneficiaries as an existing trust, with or without court or beneficiary approval has come to be called “decanting”. A power of appointment is held in a non-fiduciary capacity, typically by a beneficiary, as opposed to a power to decant which is held by a trustee in a fiduciary capacity. The Uniform Law Commission has drafted a uniform act. (See www.uniformlaws.org.)

    In Notice 2011-101 Treasury and the IRS requested help in thinking about decanting. Specifically, thirteen issues were identified:

    1. A beneficiary’s right to or interest in trust principal or income is changed (including the right or interest of a charitable beneficiary);
    2. Trust principal and/or income may be used to benefit new (additional) beneficiaries;
    3. A beneficial interest (including any power to appoint income or corpus, whether general or limited, or other power) is added, deleted, or changed;
    4. The transfer takes place from a trust treated as partially or wholly owned by a person under §§ 671 through 678 of the Internal Revenue Code (a “grantor trust”) to one which is not a grantor trust, or vice versa;
    5. The situs or governing law of the Receiving Trust differs from that of the Distributing Trust, resulting in a termination date of the Receiving Trust that is subsequent to the termination date of the Distributing Trust;
    6. A court order and/or approval of the state Attorney General is required for the transfer by the terms of the Distributing Trust and/or applicable law;
    7. The beneficiaries are required to consent to the transfer by the terms of the Distributing Trust and/or applicable local law;
    8. The beneficiaries are not required to consent to the transfer by the terms of the Distributing Trust and/or applicable local law;
    9. Consent of the beneficiaries and/or a court order (or approval of the state Attorney General) is not required but is obtained;
10. The effect of state law or the silence of state law on any of the above scenarios;

11. A change in the identity of a donor or transferor for gift and/or GST tax purposes;

12. The Distributing Trust is exempt from GST tax under § 26.2601-1, has an inclusion ratio of zero under § 2632, or is exempt from GST under § 2663; and

13. None of the changes described above are made, but a future power to make any such changes is created.

In Morse v. Kraft, 2013 Mass. LEXIS 629 (2013), Massachusetts followed the Phipps case and recognizes trustee’s power to decant trust under broad discretionary distribution power.

Robert Kraft executed an irrevocable trust agreement in 1982 that created separate trusts for his sons during their lifetimes, with each son’s children as remainder beneficiaries. At the time, the sons were minors and the trust terms prohibited the sons from participating in distributions decisions. The trust terms permitted distributions to or for the benefit of the sons at the discretion of an independent trustee, and without order or license of any court. Richard Morse served as independent trustee of the trusts since inception.

As the trustee reached 81 years old and neared retirement, he petitioned the Massachusetts Supreme Court for a determination of whether his distribution powers allowed him to decant the trusts into newly created trusts. The new trusts had the same beneficiaries of the original trusts, but each of the sons (who were then in their 40s and financially capable) would be permitted to serve as trustee of his respective trust. The trustee was not willing to decant the trusts without a determination of the authority to do so without court approval out of concerns about losing the GST exempt status of the trusts.

The case was referred to the full Massachusetts Supreme Court, with all parties consenting to the petition other than the Internal Revenue Service, which did not participate in the proceedings. The settlor, the drafting attorney, and the trustee submitted affidavits in support of the petition.

The Massachusetts Supreme Court held that the trustee had the power to decant the trusts into new trusts on the grounds that: (a) following the reasoning of Phipps v. Palm Beach Trust Co., 142 Fla. 782 (1940), the trust terms allowing the trustee broad discretion to distribute assets to or for the benefit of the beneficiary, without court approval, evidence the settlor’s intent that the trustee could distribute assets in further trust without court approval; (b) because of the trend toward state legislatures passing decanting statutes, it is not proper to recognize an inherent power in a trustee to decant regardless of the terms of the trust instrument, and the court will consider the issue on a case by case basis in the absence of a state statute; (c) in light of the increasing awareness of the benefits of including a decanting provision in a trust instrument itself, the court will consider in the future whether the failure to include this power in the trust terms suggests an intent to preclude decanting; and (d) waiver of a guardian ad litem, and the use of virtual representation to bind minor and unborn beneficiaries, is proper in this case as there are no conflicts of interest because the interests of the beneficiaries are not changed in the new trusts.
Ferri v. Powell-Ferri, 72 N.E.3d 541 (Ma. 2017) remains fascinating. The Connecticut Supreme Court asked the Massachusetts Supreme Court if a decanting were permissible under Massachusetts law. The decanting in question cut off a presently exercisable withdrawal right but the court held that was permissible. The Supreme Court opinion states:

At the time the trustees decanted the 1983 Trust assets into the 2011 Trust, under the terms of art. II.B, the beneficiary had the right to request a withdrawal of up to seventy-five per cent of the principal of the 1983 Trust. During the pendency of this action, the beneficiary reached the age of forty-seven, and his irrevocable vested interest matured into one hundred per cent of the corpus of the trust. The beneficiary states that, throughout the life of the 1983 Trust, he has requested and received only a small percentage of the trust assets.

Powell-Ferri argues that the beneficiary's right under the 1983 Trust to request a withdrawal of a certain percentage of trust assets is wholly inconsistent with the authority to decant. She contends that decanting the 1983 trust into the 2011 spendthrift trust impaired the interests of the beneficiary to withdraw trust assets upon written request.

We do not agree, for three reasons. First, Powell-Ferri's contention runs counter to our mandate to read trust provisions consistently with the entire trust document, and in a manner that gives effect to all trust language. See Hillman, 433 Mass. at 593 ("When interpreting trust language, . . . we do not read words in isolation and out of context. Rather, we strive to discern the settlor's intent from the trust instrument as a whole . . ."). If the trustee were unable to decant the portion of trust assets made "withdrawable" as the beneficiary reached certain age milestones, the trustee correspondingly would lose the ability to exercise his or her fiduciary duties (including the duty to invest and protect the assets' purchasing power) over those assets, eventually losing power to control one hundred per cent of the assets upon the beneficiary turning forty-seven years of age, pursuant to art. II.B. Under Powell-Ferri's interpretation, the trustee effectively would be without a role upon the beneficiary's reaching the age of forty-seven. This interpretation makes little sense.

Second, a trustee holds "full legal title to all property of a trust and the rights of possession that go along with it." McClintock v. Scahill, 403 Mass. 397, 399 (1988). See Welch v. Boston, 221 Mass. 155, 157 (1915) ("It is one of the fundamental characteristics of trusts that the full and exclusive legal title is vested in the trustee"). Here, at the time the trustees decanted substantially all of the 1983 Trust's assets to the 2011 Trust, the beneficiary had withdrawn only a small percentage of the assets under art. II.B. Therefore, a substantial portion of the trust assets remained in the 1983 Trust, subject to the trustee's authority and stewardship.

In analyzing the meaning of this provision, it is instructive to consider the circumstance of the termination of a trust. When a trust terminates, the beneficiaries obtain a vested interest in the trust property that is not unlike the beneficiary's withdrawal right here. Notwithstanding this vested right, however, the trustee of a terminated trust retains ongoing duties to control and protect the trust assets, and may continue to act pursuant to the powers provided under the trust instrument. See Rothwell v. Rothwell, 283 Mass. 563, 570, 572 (1933) (following trust's termination date, "the duties and powers of the trustees do not cease" until trust property is conveyed, and, until such conveyance, "the trustees [have] power to perform any act incidental to the conservation of the [trust]
property"). See Loring & Rounds, supra at § 8.2.3 ("A trustee of a terminated trust has continuing fiduciary responsibilities. . . . It is not until the trustee is done 'winding up' the trust's administration, to include making distribution 'in a manner consistent with the purposes of the trust and the interests of the beneficiaries,' is the trustee relieved of fiduciary duties" [citations omitted]).

Third, this mechanism for the beneficiary's withdrawal of trust assets does not limit the trustee's decanting authority. The two mechanisms for distribution provided under art. II are not mutually exclusive. We read arts. II.A and II.B as comprising a unified framework governing distribution of the trust assets whereby, under art. II.B, the beneficiary has a graduating right of withdrawal of those trust assets that have not been distributed pursuant to the trustee's payment to him or to the irrevocable sequestering of trust property under art. II.A.

Further, in reading arts. II.A and II.B as a coherent whole, we note that the 1983 Trust empowers the trustee to segregate assets irrevocably for "[s]o long as [the beneficiary] is living," in other words, both before the beneficiary's withdrawal rights began to vest at the age of thirty-five, and thereafter. This authority is counter to Powell-Ferri's argument that the settlor intended to bar decanting after the beneficiary gained withdrawal rights at the age of thirty-five. If decanting were so barred, art. II.A would not have allowed irrevocable sequestration for "[s]o long as [the beneficiary] is living."

Accordingly, reading the entirety of art. II in harmony, it provides that, unless and until all of the trust assets were distributed in response to the beneficiary's request for a withdrawal, the trustee could exercise his or her powers and obligations under the 1983 Trust, including the duty to decant if the trustee deemed decanting to be in the beneficiary's best interest.

Suppose under Massachusetts law a decedent created a trust giving the surviving spouse a right to withdraw and a testamentary general power. After the statute of limitations runs on the decedent’s estate tax return the trustee decants and moves all the trust property to a trust that would not be included in the spouse’s estate. The spouse sputters “but, but” but is secretly delighted – no gift, and no estate tax. Really? Or an illustration of the pernicious effect of being able to cut off withdrawal rights?

In Matter of Schreiber, N.Y. Surrogate’s Court, No. 2012-369907 (Nassau County), the court approved decanting to create supplemental needs trust for disabled beneficiary over objections of the New York Attorney General.

In 1992, Moses Ratowsky created a trust for his 19-month old grandson Daniel. The trust terms provided for wholly discretionary distributions until age 21, and thereafter for mandatory income distributions to Daniel along with Daniel’s right to withdraw the entire trust principal. After the trust was created, Daniel developed several disabilities and became the recipient of Medicaid and SSI benefits.

On May 1, 2012, the trustees decanted the trust assets into a new 3rd party supplemental needs trust that would avoid disqualifying Daniel from receiving Medicaid and SSI benefits. Under the state statute, the decanting would ordinarily become effective 30 days later (May 31, 2012), which would be after Daniel’s turning age 21 on
May 7, 2012. However, the trust terms permitted Daniel’s father to consent to the decanting on his behalf so that the decanting could become effective immediately, thereby shortening the 30-day effective period in the statute.

One of the trustees petitioned to have the court approve the decanting. The guardian ad litem approved. The New York Attorney General objected on behalf of the state’s Medicaid program administrator.

The court approved the decanting and rejected the Attorney General’s objections on the grounds that: (1) the trustee was authorized to decant because the trustee was not the settlor or a beneficiary of the trust; (2) the decanting occurred and was effective (as a result of the trust provision allowing the father to approve the immediate decanting) before Daniel’s 21st birthday and before he obtained vested rights in the trust, and therefore the new trust is not a self-settled trust; and (3) as a third-party supplemental needs trust, the new trust terms are not required to have a “payback provision”.

In re Kroll, 41 Misc. 3d 954 (Sept. 30, 2013), Trustee and Guardians of incapacitated special needs adult beneficiary allowed to decant trust into third party special needs trust on behalf of beneficiary.

Beneficiary’s grandfather established trust when beneficiary was 19 months old and prior to knowledge of beneficiary’s condition. Original trust terms required discretionary principal and income until beneficiary is age 21, then mandatory income at 21 as well as the right to withdraw trust assets, and mandatory principal distributions at 25, 30 and 35. The change in the trust terms at age 21 would disqualify beneficiary for Medicaid and SSI benefits that he currently receives.

Shortly before the beneficiary’s 21st birthday, the non-parent Co-Trustee filed the petition to decant the trust into a special needs trust, and the non-Trustee parent consented to the decant on behalf of beneficiary. Attorney General objected to the petition because it was not made by an “authorized trustee” and that the new trust is a first party self-settled trust requiring a payback provision.

The court determined “any trustee is an ‘authorized trustee’ except for a trustee who is also either the creator of the trust or a beneficiary [to whom income or principal must be paid currently or in the future or who is or will become eligible to receive a distribution of income or principal in the discretion of the trustee].”

Because the trust instrument provided that “a parent or guardian who was not also a trustee shall . . . have authority to act for the beneficiary” the court held the consent executed by the beneficiary’s non-Trustee parent was “effective to shorten the otherwise-applicable 30-day period” and therefore the effective date of the decant and transfer of assets occurred before the beneficiary reached age 21. Because prior to age 21 the beneficiary did not have a right to trust assets the new trust is a third party trust instead of a first party trust and no payback provision is required.
Prior to amendments taking effect on August 17, 2011, decanting was more limited under New York law than afterwards. Two decantings that occurred just prior to the new statute was at issue in Matter of Johnson, 2015 NY Slip Op 30017 (January 13, 2015).

In a 1985 trust for Katherine Johnson, the trustee had sole discretion to make principal distribution when the beneficiary was 25 years old and older and the trust terminated at age 35. The amendment was described by the court:

Thus, under the appointed trust instrument: (1) the trust does not terminate upon petitioner's attaining the age of 35 but instead continues for petitioner's lifetime, (2) petitioner's issue, if any, have no beneficial interest in the trust before it terminates, (3) the class of permissible appointees of the trust remainder consists not of the issue of petitioner's mother, if any, and, if none, anyone other than petitioner, her estate, her creditors, or the creditors of her estate, but, instead, consists of the issue of petitioner's father,[FN5] and (4) the remainder beneficiaries, in the event petitioner did not effectively exercise her power to appoint the trust remainder, would not be the same (e.g. the ultimate contingent beneficiary of the 1985 trust was the New York City Ballet, Inc., but the ultimate contingent beneficiaries of the appointed trust would be those persons who would qualify as the intestate distributees of petitioner's father, if he were to die on the same date as petitioner, intestate, unmarried, and a resident of New York State - a class of people that, in theory, could consist of collateral relatives of Michael L. Johnson, persons who have no interest under the 1985 trust instrument).

The court had no difficulty concluding that the trustee, Mr. Lowenfish, violated the original New York statute:

Thus, legislative history demonstrates that, under the 2011 amendment: (1) a trustee's authority was expanded and liberalized to give the trustee more flexibility than the trustee had had under the 2001 amendment; and (2) the class of successor and remainder beneficiaries of an appointed trust could be narrower than the class of successor and remainder beneficiaries of the invaded trust but could not be broader. Implicit in such expression of legislative intent is: under the 2001 amendment, a trustee would not have had the authority to decant a trust in such a way as to broaden the class of successor and remainder beneficiaries.

Here, Mr. Lowenfish did just that: the class of remainder beneficiaries of the appointed trust - both the permissible appointees and the takers in default of an effective exercise of the power of appointment - is broader than the class of remainder beneficiaries of the 1985 trust. Therefore, the July 25, 2011 decanting of the 1985 trust into the appointed trust was not in accordance with the statute in existence at that time and is invalid.[FN9]

The result in a 1997 trust was the same:

Under the terms of the 1997 instrument, the class of permissible appointees of the trust remainder consisted of petitioner's spouse and issue. By contrast, under the terms of the instrument of the appointed trust, the class of permissible appointees consisted of the issue of petitioner's father. Thus, except to the extent petitioner's spouse is excluded, the class of permissible appointees under the
appointed instrument is broader than that under the 1997 instrument. Accordingly, for the reason stated hereinbefore, the decanting of the 1997 trust violated the version of EPTL § 10-6.6(b)(1) in effect as of July 25, 2011.

Could the trustee try again now under the new statute? Would a court find answers in such action?

In Harrell v. Badger, 2015 WL 4486610 (Fla. App. 2015), the court considered a decanting that did not comply with the Florida decanting statute. The opinion states:

Here, section 736.04117(4) plainly and unambiguously requires a trustee to provide notice to “all qualified beneficiaries” of his intent to invade the principal of a trust at least 60 days prior to the invasion. Appellants are qualified beneficiaries, as defined in section 736.0103(16), Florida Statutes (2008), of the Trust because of their interest in the distribution of any principal remaining after Wilson's death. Badger improperly exercised his power to invade the principal of the Trust by failing to provide any notice to Appellants prior to transferring the entire contents of the Trust to the FFSNT.

Additionally, under section 736.04117(1)(a) 1., the decantation of trust principal is limited to situations where the beneficiaries of the second trust “include only beneficiaries of the first trust.” Here, the first trust defined Wilson as the primary beneficiary and Appellants as the contingent remainder beneficiaries. The second trust—the FFSNT sub-account—also defined Wilson as the primary beneficiary but provided a contingent remainder interest to beneficiaries of the other FFSNT sub-accounts. The second trust clearly included beneficiaries not contemplated by the original Trust, rendering Badger's decantation of all assets from the original Trust invalid.

Accordingly, we reverse and remand for the trial court to conduct an evidentiary hearing to determine the value of the Trust at the time of the decanting, reduced by the money disbursed for Wilson's actual benefit, and enter an order requiring the return of the net value to the Trust. Additionally, we reverse the trial court's retroactive approval of Badger's employment of his wife and remand for entry of an order requiring the return of Trust funds paid in commission to Badger's wife. See Shriner v. Dyer, 462 So.2d 1122, 1124 (Fla. 4th DCA 1984). Despite Badger's awareness that the employment of his wife created a conflict of interest, he proceeded to pay her commission from Trust funds without prior approval from the lower court. To the extent that any assets are restored to the Trust, we order Badger removed as its trustee.

The intended recipient trust, the FFSNT, was a pooled special needs trust.

In Hodges v. Johnson, 2017 N.H. LEXIS 232 (N.H. 2017), two irrevocable trusts were established in 2004 for the benefit of the grantor's wife, children, step-children and other descendants. The Trustees had a discretionary power to “distribute all or any portion of the net income and principal of the trust to any one or more of the group consisting of [the beneficiaries] and distributee trusts, in such amounts and at such times as the Trustee, in the Trustee’s discretion, may determine.” “Distributee trusts” were defined as any trust under the trust instruments or any other trust established by the grantor. A distributee trust could be for the benefit of one or more, “but not necessarily all,” of the beneficiaries.
The Trustees of the two irrevocable trusts decanted trust assets into new trusts and eliminated the grantor’s two step-children and one of his biological children from the definition of “descendants” in the new trust instruments, effectively stripping their interests in the trusts. The trust assets were not transferred to the new trusts. The decanting documents provided for the transfer of trust assets upon the settlor’s death. Because the parties never made arguments regarding the failure to transfer the assets, both the trial court and the Supreme Court of New Hampshire treated the decantings as if they had occurred when decanting documents were executed and that the failure to transfer assets did not render the decantings invalid.

Under New Hampshire’s decanting statute, if a Trustee has the power to make discretionary distributions of principal to one or more beneficiaries, the Trustee may decant the assets to a new trust that eliminates one of those beneficiaries as a beneficiary of the new trust. The statute further provides that “[i]n exercising the power to decant, a trustee has a duty to exercise the power in a manner that is consistent with the settlor’s intent as expressed in the terms of the trust, and the trustee shall act in accordance with the trustee’s duties under this chapter and the terms of the first trust.” RSA 564-B:4-418.

The trial court set aside the decantings and removed the Trustees. On appeal to the Supreme Court of New Hampshire, the court stated that even though New Hampshire’s decanting statute allowed the Trustees to eliminate beneficiaries, and even though the Trustees had the discretion to distribute income and principal in the Trustees’ discretion, the Trustees were still subject to the duty of impartiality in carrying out the decanting. The court stated that “a trustee, who makes unequal distributions among beneficiaries and/or eliminates a beneficiary’s non-vested interest in an irrevocable trust through decanting, violates the statutory duty of impartiality only when the trustee fails to treat the beneficiaries ‘equitably in light of the purposes and terms of the trust.’” (quoting Uniform Trust Code § 803 Cmt.).

The court agreed with the trial court that the decantings were improper and void because the decantings violated the Trustees’ duty of impartiality by failing to consider the interests of all of the beneficiaries, both present and remainder. It is difficult to understand why a trustee would think it could decant under such circumstances.

In Matter of Hoppenstein, 2017 N.Y. Misc. LEXIS 1707 (N.Y. Surr. 2017); 2017 N.Y. Misc. LEXIS 3851 (N.Y. Surr. 2017), Reuben Hoppenstein created an irrevocable trust in 2004 (the “2004 Trust”). The Trustee was authorized to distribute income to Hoppenstein’s descendants. Regarding the distribution of principal, the governing instrument of the 2004 Trust stated that the Trustees may distribute principal, including the entire principal, to Hoppenstein’s descendants. Distributions could be made in equal or unequal amounts and could exclude certain descendants in favor of other descendants. The Trustees could make these determinations regarding principal in the Trustees’ sole discretion. The 2004 Trust instrument specifically authorized a distribution to a beneficiary to be applied “by payment to a trust for his or her benefit.”

After the 2004 Trust was established, Hoppenstein’s relationship with one of his daughters soured. Hoppenstein created another irrevocable trust in 2012 (the “2012 Trust”). The 2012 Trust instrument excluded the
daughter as a beneficiary. Later in 2012, the Trustees transferred a life insurance policy held by the 2004 Trust to the 2012 Trust.

The daughter and her children objected to the transfer on numerous grounds, including that the transfer did not meet the requirements of New York’s decanting statute, NY EPTL 10-6.6. The court stated that this argument was immaterial because the Trustees did not rely on the statute for authority to transfer the life insurance policy, but rather relied on their authority to make discretionary distributions of principal. In addition, the decanting statute specifically provides the statute “shall not be construed to abridge the right of any trustee to appoint property in further trust that arises under the terms of the governing instrument of a trust . . .”

The beneficiaries also held Crummey withdrawal rights under the 2004 trust. The beneficiaries argued that, at the time the policy was transferred to the 2012 Trust, the beneficiaries still held unexercised rights of withdrawal over trust assets, which gave them vested rights in the policy that should have prevented the decanting. The court, however, discussed a calculation of the value of each beneficiary’s right of withdrawal from the time that the 2004 Trust was established until the policy was transferred and determined that the all of the beneficiaries’ rights of withdrawal had lapsed by the time the policy was transferred. The court also rejected the beneficiaries’ argument that certain rights of withdrawal never lapsed because they never received a Crummey notice, relying on Estate of Turner v. Commissioner, T.C. Memo. 2011-209.

Where a charitable trust had two trustees, both trustees had to consent, rather than one trustee being able to decant half the trust. In the Matter of the Fund for the Encouragement of Self Reliance, An Irrevocable Trust, 2019 WL 1867525 (Nv. 2019).

PART 3 – STATE DEVELOPMENTS

U. STATE DEVELOPMENTS

1. Trust Modification To Allow Trustee Removal Under Pennsylvania Law and the UTC. Pennsylvania has adopted the Uniform Trust Code, in particular certain beneficiary amendment procedures and trustee removal procedures. In In re Trust of Taylor, 124 A.3d 334 (Pa. Super. 2015), some of the beneficiaries wanted a court to approve adding a trustee removal provision so they would not have to remove as required under the UTC which requires some form of “cause.” The corporate trustee objected but the court approved the modification. The opinion states:

We reject the Orphans' Court's conclusions for several reasons. First, contrary to Wells Fargo's contention and the conclusion reached by the court, Appellants did not seek currently to remove Wells Fargo as trustee. Rather, Appellants requested strictly to amend the trust to provide the flexibility to allow the beneficiaries to remove the trustee if, at some future point, they saw fit to do so. By imputing motives to the Appellants based on assumptions not supported by the record, the court engaged in inappropriate speculation and conjecture and based its finding on a false premise.
Second, having established that false premise, the Orphans' Court proceeded to improperly apply the rules of statutory construction to interpret a statute that is, in fact, unambiguous on its face. The court's contorted reading of the words “under this section” in section 7740.1(d)(1)—apparently construed as a reference to the Uniform Trust Act as a whole—provided an opening for the wholesale importation of the requirements of section 7766. We see no textual support for this strained interpretation. Rather, it is clear that subsection (d)(1)'s reference to “this section” refers only to section 7740.1 itself. Read in its proper context, subsection (d)(1) allows modification by some beneficiaries, with court approval, in the same manner as would have been allowed under subsection (b), which permits court modification where (1) all beneficiaries consent and (2) the modification “is not inconsistent with a material purpose of the trust.” 20 Pa.C.S.A. § 7740.1(b).

Contrary to the findings of the Orphans' Court, section 7740.1 is clear and unambiguous on its face, and must be applied as such. As written, the statute contains no language excluding from its ambit the modification of trustee-removal provisions. Had the legislature wished to restrict the application of section 7740.1 to exclude modifications involving portability provisions, it certainly could have created an exception, or included an incorporating cross-reference to section 7766. It chose not to do so. It is not for the courts to impose additional restrictions as they may see fit, regardless of what the court may perceive as the petitioners' underlying motives.

Finally, we note that Wells Fargo's heavy reliance on the statutory comments is misplaced. “[O]nly when the words of a statute are ambiguous should a court seek to ascertain the intent of the General Assembly through consideration of statutory construction factors found in [s]ection 1921(c).” Commonwealth v. Brown, 603 Pa. 31, 981 A.2d 893, 898 (2009). As we have already noted, the words of section 7740.1 are clear and unambiguous on their face. Accordingly, it is unnecessary and, indeed, improper to resort to the canons of statutory construction. Cavallini, supra. See also 1 Pa.C.S.A. § 1939 (where conflict exists between comments and statutory language, statutory language controls).

The Supreme Court of Pennsylvania reversed the Superior Court and ruled against the grandchildren beneficiaries’ request to reform the trust in In Re Trust Under Agreement of Taylor,164 A.3d 1147 (Pa. 2017). The Supreme Court concluded that the UTA does not permit the removal and replacement of a Trustee without Orphans’ Court approval.

In making its ruling, the court concluded that, when reading section 7740.1 in conjunction with section 7766, ambiguities exist. The court noted that there are two plausible interpretations of the plain language of the two provisions. The corporate Trustee may be removed, and replaced, only pursuant to section 7766. So a modification pursuant to 7740.1 to add a portability provision would essentially circumvent the requirements for removal and replacement of the Trustee in section 7766. Because of these ambiguities, the Court determined that the sections must be construed in such a way that one section does not nullify the other.

Here, permitting beneficiaries to modify a trust agreement pursuant to section 7740.1 to add a portability clause would have precisely this effect; to “nullify, exclude or cancel” the effectiveness of section 7766. To obtain a modification under section 7740.1 to permit beneficiaries to remove and replace a Trustee, the beneficiaries need
only show that the modification would not be inconsistent with a material purpose of the trust. On the other hand, to remove and replace a Trustee pursuant to section 7766, beneficiaries must demonstrate substantial evidentiary hurdles and the court must make numerous findings of fact and conclusions of law.

Of course there is another key practical difference between the use of the two sections: to modify the trust required functional unanimous agreement of the beneficiaries. Regardless, the court held that the scope of section 7740.1 of the UTA does not extend to modification of trust agreements to permit the removal and replacement of Trustees.

The opinion notes that two other states specifically prohibited modifications that would allow removals, without drawing the conclusion that those states must have read the default UTC language differently, at least in part, from the way the Pennsylvania Supreme Court was about to read it. The opinion notes:

Moreover, the provisions are ambiguous because neither section contains any explicit language addressing the issue raised here. Unlike our General Assembly, two other states have, in enacting modified versions of the UTC, included express language providing that their general modification provisions may not be used to remove or replace a trustee, and that instead removal and replacement of a trustee by the beneficiaries must be accomplished pursuant to their more specific “removal of trustee” provision elsewhere in the statute. Iowa’s general modification provision, for example, states that “removal of the trustee or the addition of a provision to the trust instrument allowing a beneficiary or a group of beneficiaries to remove the trustee or to appoint a new trustee shall not be allowed as a modification under this section.” Iowa Code Ann. § 633A.2203. Instead, removal and replacement of a trustee must be effectuated pursuant to section § 633A.4107 of the Iowa Code (“Removal of trustee”). Similarly, Ohio’s general modification provision states that a “noncharitable irrevocable trust may be modified, but not to remove or replace the trustee, upon consent of all of the beneficiaries if the court concludes that modification is not inconsistent with a material purpose of the trust.” Ohio Rev. Code Ann. § 5804.11 (emphasis added). In Ohio, a trustee must be removed and replaced in accordance with the more rigorous requirements of a separate provision entitled “Removal of trustee.” Ohio Rev. Code Ann. § 5807.06.

Suppose the modification had been to grant a non-beneficiary powerholder an inter vivos, very broad, non-general power of appointment. Would the trustee have screamed about the possibility of the power being exercised to dislodge it? Suppose the powerholder modified the trust to achieve better basis but also to remove the trustee. Is the one action permitted, the other not? Suppose the powerholder appointed the assets into a new and identical trust with one minor change: the trust could invest only in time-shares and virtual currency. Would the trustee have argued a constructive removal, akin to no air conditioning in rental housing in warm climates, or would the trustee have hurriedly resigned to avoid the investment directives? Indeed, what if the powerholder had terminated the trust; should we envision the trustee as cowboy, the Pennsylvania Supreme Court as trusty steed, galloping after the assets formerly in trust to avoid the trustee’s role being eliminated? The general suspicion is that the beneficiaries should have been more circumspect in their planning.
In In re: Warriner Trusts, 6 Fid. Rep. 3d 223 (O.C. Susq. 2018), in the Orphans’ Court of Susquehanna County, Pennsylvania, is a long opinion dealing with the request of beneficiaries to remove and replace a corporate trustee. The court notes the legal standards:

Newlin, as an individual trustee of the Warriner Trusts, may petition for the removal of Wells Fargo as the corporate trustee. 20 Pa. C.S. § 7766(a). In order for Newlin's petition to be granted, the court must find that the removal “serves the best interests of the beneficiaries of the trust and is not inconsistent with a material purpose of the trust.” 20 Pa. C.S. § 7766(b). Moreover, the court must also determine that a suitable successor trustee is available. 20 Pa. C.S. § 7766(b). Finally, the court must likewise find that one of the following factors have been established:

(1) the trustee has committed a serious breach of trust;

(2) lack of cooperation among cotrustees substantially impairs the administration of the trust;

(3) the trustee has not effectively administered the trust because of the trustee's unfitness, unwillingness or persistent failures; or

(4) there has been a substantial change in circumstances. A corporate reorganization of an institutional trustee, including a plan or merger or consolidation, is not itself a substantial change of circumstances.

20 Pa. C.S. § 7766(b)(1)-(4). As such, Newlin “must show by clear and convincing evidence that: “(1) the removal serves the beneficiaries best interests; (2) the removal is not inconsistent with a material purpose of the trust; (3) a suitable successor trustee is available; and (4) a substantial change in circumstances has occurred.” In re McKinney, 67 A.3d 824, 830 (Pa. 2013); In re Estate of Mumma, 41 A.3d 41, 50 (Pa. Super. Ct. 2012) (finding that “clear and convincing” evidence standard applied to action seeking removal of trustee).

B. Best Interests of Beneficiaries

When considering whether removal of a corporate trustee serves the best interests of the beneficiaries, this factor does not require proof that Wells Fargo had engaged in conduct that harmed the trust beneficiaries. See McKinney, 67 A.3d at 832. Instead, when assessing whether replacement of a corporate trustee will serve the best interests of the trust beneficiaries, a trial court has broad discretion to consider the following factors:

Personalization of service; cost of administration; convenience to the beneficiaries; efficiency of service; personal knowledge of trusts' and beneficiaries' financial situations; location of trustee as it affects trust income tax; experience; qualifications, personal relationship with beneficiaries; settlor's intent as expressed in the trust document; and other material circumstances.

McKinney, 67 A.3d at 833. None of these particular factors has greater weight than the other and the factors must be assessed on a case-by-case basis. See McKinney, 67 A.3d at 834. The court will now consider the applicable factors enunciated by McKinney as they relate to the best interests of the beneficiaries of the Warriner Trusts.
Among the interesting points in the opinion are:

During his service as a trustee of the Warriner Trusts over the past 50 years, Newlin has experienced numerous corporate mergers. Each merger resulted in the corporate trustee progressively becoming a larger banking institution. The Warriner Trusts initially started with a large Pennsylvania banking institution that had strong personal connection with the settlors. Over the course of five decades and numerous mergers, the corporate trustee has morphed into a financial behemoth. Wells Fargo has approximately 100 times more employees than The First Pennsylvania Banking and Trust Company employed in 1956 – and 200 times more offices. Based upon the continued growth of the corporate trustee, Newlin and the beneficiaries of the Warriner Trusts perceive that the level of personalized service has deteriorated as increased centralization and consolidation has replaced the traditional personalized service trust model.

2. **Service as Investment Advisor Confers Jurisdiction On A State With Jurisdiction Over The Trust.** Nevada has a statute dealing with jurisdiction over trust protectors and trust advisors; NRS 163.5555 provides:

   If a person accepts an appointment to serve as a trust protector or a trust adviser of a trust subject to the laws of this State, the person submits to the jurisdiction of the courts of this State, regardless of any term to the contrary in an agreement or instrument. A trust protector or a trust adviser may be made a party to an action or proceeding arising out of a decision or action of the trust protector or trust adviser.

In *Matter of Beatrice B. Davis Family Heritage Trust*, 394 P.3d 1203 (NV. 2017), the court construed that statute to mean exactly what it says. The opinion states:

An exercise of personal “[j]urisdiction over a nonresident defendant is proper only if the plaintiff shows that the exercise of jurisdiction satisfies the requirements of Nevada's long-arm statute and does not offend principles of due process.” *Viega GmbH v. Eighth Judicial Dist. Court*, 130 Nev. ——, 328 P.3d 1152, 1156 (2014). NRS 14.065, Nevada's long-arm statute, “reaches the constitutional limits of due process under the Fourteenth Amendment, which requires that the [nonresident] defendant have such minimum contacts with the state that the [nonresident] defendant could reasonably anticipate being hauled into court [in Nevada], thereby complying with traditional notions of fair play and substantial justice.” *Id.* (internal quotation marks omitted). “Due process requirements are satisfied if the nonresident defendants' contacts [with Nevada] are sufficient to obtain either (1) general jurisdiction, or (2) specific personal jurisdiction and it is reasonable to subject the nonresident defendants to suit here.” *Id.*

“Unlike general jurisdiction, specific jurisdiction is proper only where the cause of action arises from the defendant's contacts with the forum.” Id. (internal quotation marks omitted). More specifically, in order for Nevada courts to exercise specific personal jurisdiction over a nonresident defendant,

[the defendant must purposefully avail himself of the privilege of acting in [Nevada] or of causing important consequences in [Nevada]. The cause of action must arise from the consequences in the forum state of the defendant's activities, and those activities, or the consequences thereof, must have a substantial enough connection with [Nevada] to make the exercise of jurisdiction over the defendant reasonable.


We conclude Nevada courts may exercise specific personal jurisdiction over persons accepting a position as an ITA in Nevada should the suit “arise [ ] out of a decision or action of the trust protector or trust adviser.” NRS 163.5555. Accepting a role as an ITA manifests a defendant's purposeful availment of the privilege of acting in Nevada; where, as here, a suit arises out of a nonresident defendant's role as an ITA, the exercise of specific personal jurisdiction would satisfy the requirements of Nevada's long-arm statute, as well as traditional notions of fair play and substantial justice. Accordingly, we deny Christopher's writ petition.

3. State Statute Cannot Limit Jurisdiction of Other States or of Federal Bankruptcy Court.

In Toni 1 Trust v. Wacker, 2018 WL 1125033 (Alaska 2018), a Montana state court entered a series of judgments against the Tangwell family, after which the Tangwell family transferred two pieces of property to the Toni 1 Trust which the court treated as an Alaskan trust. A Montana state court and an Alaska bankruptcy court each found that the transfers were made to avoid the judgments against the Tangwell family and were therefore fraudulent. The Trustee of the trust filed suit, arguing that Alaska state courts have exclusive jurisdiction over fraudulent transfer actions under Alaska Statute 34.40.110(k), and requesting the judgments of the other courts be declared void for lack of subject matter jurisdiction.

Alaska law provides for self-settled spendthrift trusts, under Alaska Statute 24.40.110. Subsection (b)(1) of that statute creates a limited cause of action for fraudulent transfers: a creditor of the settlor of the trust can reach trust property if the creditor can prove that the settlor’s transfer of the property to the trust was made with the “intent to defraud that creditor.” This is the only cause of action by which a litigant can reach property in an Alaska self-settled spendthrift trust, and the statute provides that Alaska courts have “exclusive jurisdiction over an action brought under a cause of action or claim for relief that is based on a transfer of property to a [self-settled spendthrift] trust.” Alaska Statutes 24.40.110(k)

The Trustee argued, and the legislative history showed, that this provision is meant to prevent other state and federal courts from exercising subject matter jurisdiction over fraudulent transfer actions against Alaskan self-settled spendthrift trusts. However, the court held that a statute could not circumscribe other courts’ jurisdiction in such a manner, citing to Tenn. Coal, Iron, & R.R. Co. v. George, 833 U.S. 354 (1914), which stated that the Full
Faith and Credit Clause does not compel states to follow another state’s statute claiming exclusive jurisdiction even though the other state created the right of action. The court specifically noted that while comity suggests that limitations one state’s legislature places on its own laws would be universally acknowledged, comity is not a legal rule, and courts are not compelled to apply it. See Marine Midland Bank v. United Mo. Bank, 643 N.Y.S.2d 528 (N.Y. App. Div. 1996) (“Comity does not require or suggest that the courts of this State should surrender their interest in adjudicating disputes…”). The opinion states:

In seeking to void the Montana court's judgment for lack of jurisdiction, Tangwall effectively argues that AS 34.40.110(k) can deprive Montana courts of jurisdiction over cases arising under Montana law. This is simply a more extreme interpretation of the “full faith and credit” principle than the interpretation considered and rejected in Tennessee Coal.

We acknowledge that the Alaska legislature's attempt to grant Alaska courts exclusive jurisdiction over a class of claims in some circumstances is hardly unique. And we acknowledge that several of our sister states have concluded that similar statutes do, in fact, restrict their jurisdiction. However, those courts have relied on reasoning that is not applicable to AS 34.40.110(k). First, “[s]ome state courts have applied state-law distinctions between local and transitory actions to make discretionary decisions whether to stay or dismiss an action in favor of another forum.” Tennessee Coal established that “a state cannot create a transitory cause of action and at the same time destroy the right to sue on that transitory cause of action in any court having jurisdiction”— which suggests that states are not barred from asserting exclusive jurisdiction when the cause of action is local rather than transitory. However, AS 34.40.110(k) grants Alaska courts exclusive jurisdiction over fraudulent transfer actions against Alaska trusts, and fraudulent transfer actions are transitory actions.

Other courts have declined to hear cases on the basis of an exclusive jurisdiction provision without addressing the Tennessee Coal rule. One of these — a Virginia court—elected to respect an assertion of exclusive jurisdiction because “comity suggests that limitations one state's legislature places on its own laws be universally acknowledged.” But comity is not a legal rule; rather it is “a principle under which the courts of one state give effect to the laws of another state ... out of deference or respect.” In other words, while courts may elect to follow a statute like AS 34.40.110 out of comity, they are not compelled to do so. Furthermore, AS 34.40.110 is more than a “limitation[ ] [Alaska's] legislature place[d] on its own laws”—it purports to deprive other states of jurisdiction over all fraudulent transfer actions concerning Alaska trusts, even those based on causes of action arising under that state's own law.

Tangwall directs our attention to several Delaware statutes that purport to grant the Delaware Court of Chancery exclusive jurisdiction over certain suits, and he correctly asserts that some state courts have concluded that these statutes limit their jurisdiction. In 2014, however—following these decisions—the Delaware Court of Chancery reached the opposite conclusion. In IMO Daniel Kloiber Dynasty Trust, the court noted that “courts outside of Delaware are divided as to whether Delaware can establish an exclusive forum for certain state law claims.” Citing Tennessee Coal, it sided with those courts that had “declined to interpret the exclusive jurisdiction language in Delaware's statutes as precluding them from hearing a case,” reasoning that “Delaware ... cannot unilaterally preclude a sister state from hearing claims under [that state's] law.”
We agree with the Court of Chancery and with those courts that have reached similar conclusions. The basic principle articulated in *Tennessee Coal* has not changed in the last century. As applied to this case, it means that AS 34.40.110(k)'s assertion of exclusive jurisdiction does not render a fraudulent transfer judgment against an Alaska trust from a Montana court void for lack of subject matter jurisdiction. We therefore cannot grant Tangwall the relief that he seeks from the Montana judgment.

Footnote 25 points to:


Specifically, if the statute at issue were interpreted to deny parties access to the federal courts without those courts’ consent, the statute “might well run afoul of the Supremacy Clause.” *Allstate Ins. Co. v. Gammon*, 838 F.2d 73 (3d Cir. 1988).

4. **Access To Decedent's Email.** *Ajemian v. Yahoo!, Inc.*, 478 Mass. 169 (Ma. 2017) deals with an interesting issue of federal law and certain other collateral matters. The decedent died in 2006, intestate and without any documentation about his email. The decedent’s siblings, as personal representatives, wanted the decedent’s email from his Yahoo! account which Yahoo! refused to provide. The court discusses Yahoo!’s rationale as follows

Yahoo contends that 18 U.S.C. § 2702(a) [the so-called Stored Communications Act] prohibits it from disclosing the contents of the e-mail account, while the personal representatives argue that they fall within two of the enumerated exceptions. The first of these, the so-called “agency exception,” allows a service provider to disclose the contents of stored communications “to an addressee or intended recipient of such communication or an agent of such addressee or intended recipient.” 18 U.S.C. § 2702(b)(1). The second, the “lawful consent” exception, allows disclosure “with the lawful consent of the originator or an addressee or intended recipient of such communication, or the [originator] in the case of remote computing service.” 18 U.S.C. § 2702(b)(3). We address the applicability of each exception in turn.

The court determined that the personal representatives were not agents of the deceased:

Under the common law, both as construed in the Commonwealth and more generally, an “agent” “act[s] on the principal's behalf and [is] subject to the principal's control.” Restatement (Third) of Agency § 1.01 (2006). See *Theos & Sons, Inc. v. Mack Trucks, Inc.*, 431 Mass. 736, 743, 729 N.E.2d 1113 (2000) (“An agency relationship is created when there is mutual consent, express or implied, that the agent is to act on behalf and for the benefit of the principal, and subject to the principal's control”). The decedent's personal representatives do
not fall within the ambit of this common-law meaning; they were appointed by, and are subject to the control of, the Probate and Family Court, not the decedent.

[Citations omitted]

The personal Representatives had more luck with the lawful consent exception:

We thus are confronted with the novel question whether lawful consent for purposes of access to stored communications properly is limited to actual consent, such that it would exclude a personal representative from consenting on a decedent's behalf. We conclude that interpreting lawful consent in such a manner would preclude personal representatives from accessing a decedent's stored communications and thereby result in the preemption of State probate and common law. Absent clear congressional intent to preempt such law, however, there is a presumption against such an interpretation. See *Egelhoff v. Egelhoff ex rel. Breiner*, 532 U.S. 141, 151, 121 S.Ct. 1322, 149 L.Ed.2d 264 (2001) ("[R]espondents emphasize that the Washington statute involves both family law and probate law, areas of traditional [S]tate regulation. There is indeed a presumption against pre-emption in areas of traditional [S]tate regulation such as family law"); *United States v. Texas*, 507 U.S. 529, 534, 113 S.Ct. 1631, 123 L.Ed.2d 245 (1993) ("[s]tatutes which invade the common law ... are to be read with a presumption favoring the retention of long-established and familiar principles, except when a statutory purpose to the contrary is evident" [citation omitted] ). The statutory language and legislative history of the lawful consent exception in the SCA do not evidence such a congressional intent.

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At common law, a personal representative also may provide consent on a decedent's behalf to the waiver of a number of rights, including the attorney-client,20 physician-patient,21 and psychotherapist-patient privilege.22 Under the Uniform Probate Code,23 a personal representative may sell a decedent's property, Uniform Probate Code § 3–715(23); bring claims on the decedent's behalf, id. at § 3–715(22); and vote the decedent's stocks, id. at § 3–715(12). Thus, a construction of lawful consent that allows personal representatives to accede to the release of a decedent's stored communications accords with the broad authority of a lawfully appointed personal representative to act on behalf of a decedent.

Finally, had Congress intended lawful consent to mean only actual consent, it could have used language such as “actual consent” or “express consent” rather than “lawful consent.” See, e.g., 18 U.S.C. § 2721(a)(2) (prohibiting State departments of motor vehicles from releasing personal information “without the express consent of the person to whom such information applies” [emphasis supplied]); *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 176, 114 S.Ct. 1439, 128 L.Ed.2d 119 (1994) (Congress knew how to provide for liability for aiding and abetting but chose not to do so); *Pinter v. Dahl*, 486 U.S. 622, 650, 108 S.Ct. 2063, 100 L.Ed.2d 658 (1988) ("When Congress wished to create [substantial factor liability for an offense], it had little trouble doing so"); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 734, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975) ("When Congress wished to provide a remedy to those who neither purchase nor sell securities, it had little trouble doing so expressly").
Accordingly, nothing in the language of the “lawful consent” exception evinces a clear congressional intent to preempt State probate and common law allowing personal representatives to provide consent on behalf of a decedent.

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Beyond Congress's overarching purpose in passing the SCA, the House committee report notes that “lawful consent” “need not take the form of a formal written document of consent.” H.R. Rep. No. 647, 99th Cong., 2d Sess., at 66. Instead, such consent “might be inferred to have arisen from a course of dealing ...—e.g., where a history of transactions between the parties offers a basis for reasonable understanding that a consent to disclosure attaches to a particular class of communications.” Id. Moreover, lawful consent could “flow from a user having had a reasonable basis for knowing that disclosure or use may be made with respect to a communication, and having taken action that evidences acquiescence to such disclosure or use—e.g. continued use of such an electronic communication system.” Id.

Yahoo! also argued that the decedent signed a terms of service agreement that trumps everything. The court noted:

The express language of the termination provision, if enforceable, thus purports to grant Yahoo the apparently unfettered right to deny access to the contents of the account and, if it so chooses, to destroy them rather than provide them to the personal representatives.

Because the record before him was not adequate to establish the essentials of valid contract formation, the judge was unable to determine—even as an initial matter—whether the terms of service agreement could constitute an enforceable contract. The judge observed that Yahoo had not established that a “meeting of the minds” had occurred with respect to the terms of service, including whether they had been communicated to, and accepted by, the decedent. The judge accordingly denied Yahoo's motion for summary judgment on this alternative ground. We discern no error in this regard, and remand the matter for further proceedings.

A dissent would have ordered Yahoo! to turn over the emails immediately.

The Revised Uniform Fiduciary Access to Digital Assets Act deals with the lawful consent issue by requiring a decedent to give authority to a personal representative in a Will, and then providing various procedural steps (court order for example) before a service provider must provide emails. This Act has been adopted in 39 or more jurisdictions. The original version of the Act, which was opposed by the internet companies and proved unpassable, presumed consent. The policy argument was that we should not require people to have Wills. The providers reply was that we shouldn’t run roughshod over contracts either.

Matter of Coleman, 63 Misc. 3d 609 (N.Y.S. Westchester 2019), involved access to an iPhone. Ryan Coleman died in his sleep at age 24; an autopsy was undeterminative. His parents wanted access to his iPhone. The decedent had no Will and had not used an on-line tool providing access. The court denied the request, granting
access only to the “non-content” information. If the parents discovered a good reason they needed access to the content they could re-petition the court. The reasons offered at this stage were:

(1) determine whether Ryan had any medical issues that his two younger siblings may also have; (2) determine whether any legal action on behalf of Ryan's estate may be appropriate; (3) identify and collect Ryan's digital and non-digital assets; and (4) marshal any of Ryan's digital assets as part of the estate administration. They also asked that the court make certain findings including that Ryan maintained an iCloud account associated with the Georgetown email address and that he owned a certain iPhone.

The Court summarized the prior New York case as follows:

In Matter of White (NYLJ, Oct. 3, 2017 at 25, col 1 [Sur Ct, Suffolk County 2017]), the fiduciary of the decedent's estate sought an order granting him access to the decedent's email account with Google, Inc. The fiduciary alleged that the decedent may have owned a business at the time of his death, and he needed access to the email account to confirm that this business existed to administer this potential asset for the estate.

In permitting access to the email account only to the extent of requiring Google to disclose the “contacts information stored and associated with the email account,” the court noted the importance of balancing a fiduciary's duty to properly administer the estate with the possibility of the unintended consequences of disclosure of “sensitive or confidential data” regarding the decedent (id.). The court wrote “unfettered access to a decedent's digital assets may result in an unanticipated intrusion into the personal affairs of the decedent” that is unrelated to the reasons the content of the emails was sought (id.).

In Matter of Serrano (56 Misc 3d 497 [Sur Ct, NY County 2017]), the decedent's fiduciary requested access to his deceased spouse's Google email, contacts, and calendar information to “be able to inform friends of his passing” and “close any unfinished business.” In limiting the permissible disclosure to the non-content contact list and calendar information associated with the decedent's account, the court, citing EPTL 13 - A-3.2, stated that the record before the court indicated that this data was all that was “reasonably necessary for the administration of the estate” (id. at 499). The court held open the possibility of a renewed application in which the fiduciary showed how the content information was necessary to the estate administration.

In Matter of Swezey (NYLJ, Jan. 18, 2019 at 34, col 2 [Sur Ct, NY County 2019]), the fiduciary commenced an SCPA 2103 turnover proceeding against Apple seeking the decedent's photographs which were stored on iTunes and iCloud. There, the decedent did not use an online tool to provide direction for his digital assets and, although he died testate, he did not specifically provide for the disposition of his digital assets. In ordering Apple to disclose the photographs, the court relied on the facts that, in the decedent's last will and testament, he left his personality and his residuary estate to his surviving spouse and that the decedent and his spouse “gave to each other implicit consent to access each other's digital assets” (id). In doing so, the court quoted EPTL 1-2.15, noting that a decedent's property is “defined as ‘anything that may be the subject of ownership,’ ‘real or personal’” and that “include[s] assets kept in a digital form in cyberspace” (id.).
In re Scandalios, 2019 WL 266570 (N.Y. Sur. 2019) involved a 45-year old photographer who died with a wife and two minor children. The opinion states:

A Digital assets are “electronic record[s] in which an individual has a right or interest” (EPTL 13-A-1 [i]), which consist of electronic communications and other digital assets that are not electronic communications. This distinction is significant in that disclosure of electronic communications, unlike disclosure of other digital assets, requires proof of a user's consent or a court order (EPTL 13-A-3.1; see Matter of Serrano, 56 Misc 3d 497 [Sur Ct, NY County 2017]).

Here, decedent's photographs stored in his Apple account are not “electronic communications,” the disclosure of which, in the absence of a court order, requires consent of the account holder in any form listed under EPTL 13-A-2.2. Therefore, Apple is required to disclose the photographs stored in decedent's Apple account associated with his Apple ID identifiable by decedent's two email accounts as listed in the petition (EPTL 13-A-3.2).

Accordingly, and in order to provide petitioner with the order that he seeks to satisfy Apple's request, the court makes findings and enters directions as follows (EPTL 13-A-3.2 [d][4]): (1) decedent was the user of an account with Apple, the ID for which is either of the two email accounts provided by petitioner, an individual with personal knowledge that decedent was the user of those email accounts; (2) petitioner is the fiduciary of decedent's estate; and (3) no lawful consent is required for disclosure of these photographs under the Stored Communications Act (18 USC §§ 2701 et seq. [part of the Electronic Communication Privacy Act of 1986]) or the New York Administration of Digital Assets law (EPTL Article 13-A) and, in fact, EPTL 13-A-3.2 mandates disclosure of such.

Based on these findings, upon service of a copy of this decision and order, Apple shall afford petitioner the opportunity to reset the password to decedent's Apple ID.

The decedent’s will did not provide for access to the decedent’s digital assets.

5. **Determination of Domicile.** Some states are sticky when you try to change your domicile to elsewhere. New York is such a state. Gregory Blatt was successful at the New York Division of Tax Appeals, thanks in part to his loyal and (no doubt) tax-wise dog. In the Matter of the Petition of Gregory Blatt (Determination DTA No. 826504), New York Division of Tax Appeals (February 2, 2017). The opinion states:

F. While the standard is subjective, the courts and the Tax Appeals Tribunal have consistently looked to certain objective criteria to determine whether a taxpayer’s general habits of living demonstrate a change of domicile. “The taxpayer must prove his subjective intent based upon the objective manifestation of that intent displayed through his conduct” (Matter of Simon, Tax Appeals Tribunal, March 2, 1989). Among the factors that have been considered are: the retention of a permanent place of abode in New York, the location of business activity, the location of family ties, the location of social and community ties and formal declarations of domicile.

G. With respect to the factor regarding the retention of a permanent place of abode, there is no question that petitioner maintained his apartment on West 11
Street during the audit period. The Division states that this is an extremely significant factor since petitioner was extensively involved in the renovations made to this apartment after he purchased it, that these renovations lasted over 18 months and that, in comparison to his apartments in Dallas, the New York City apartment was owned by him rather than leased.

Although the retention of his New York City apartment is a factor to consider, it is necessary to review the totality of the factors coupled with petitioner’s intentions at the time of the audit period. When viewing the circumstances surrounding petitioner’s lifestyle and employment during the audit period, it is determined that his retention of his New York City apartment did not outweigh his overall intention to change his domicile to Dallas.

H. Petitioner’s decision regarding where to live revolved around his employment opportunities. Petitioner was born and raised in the metropolitan Boston area. He moved to New York to pursue his education. Petitioner, as a single man, did not have any family ties to New York. Petitioner originally moved to New York City in August of 1992, when he was enrolled in law school at Columbia University. In fact, he remained in the same apartment here he lived as a student for over 13 years.

In late 2005, at the age of 37, petitioner decided it was time to purchase a home and did so. At this time, he had been working for IAC as general counsel. His employment was a major component of his lifestyle. By November of 2006, petitioner’s job title was Executive Vice President, General Counsel & Secretary of IAC and his principal place of employment was at the company’s offices in New York City. He handled mergers and acquisitions, securities work and managed a legal department of roughly 50 people.

However, by August of 2008, IAC underwent a significant restructuring and the company split into five pieces, which reduced IAC into a fraction of its former size. This restructuring altered the scope of petitioner’s job. Petitioner testified that his job became much smaller and less prestigious to him. Therefore, he began to look for other job opportunities.

Petitioner testified that he was offered the job of running Match in Dallas just prior to the beginning of the audit period. At this time, petitioner had recently ended a long-term personal relationship and the changes at IAC left him professionally unfulfilled. Petitioner testified that he was ready for a change and the opportunity presented by employment as CEO of Match was too good to pass up.

In negotiating the terms of the job at Match, petitioner retained a corporate role with IAC and retained the right to have New York City be his primary work location. Petitioner explained that he had some preconceived notions regarding life in Texas and wanted to ensure that he had a safety net in case the job was not all he hoped for. Soon after his arrival at Match, petitioner embraced both the job at Match and life in Dallas.

I. By the fall of 2009, petitioner began a process by which he gave up his titles and responsibilities at IAC and to designate Dallas as his principal place of employment. Petitioner put his New York City apartment up for sale. He began dating and enjoying the social scene in Dallas. He spent significant time with his close, childhood friend, Steven Becker, who also lived in Dallas and Mr. Becker’s son, who was petitioner’s godchild. Petitioner joined a gym and utilized doctors in Texas.
Following the summer of 2009, petitioner took the final step in his relocation to Dallas by moving his dog there. Petitioner testified to the difficulty surrounding the decision to move his large, senior dog to Dallas due to her size and advanced age, coupled with the extreme heat and humidity of Dallas. Petitioner waited until the timing was appropriate. In reviewing the factors of a change in domicile, historically, the move of items near and dear tend to demonstrate a person’s intention. As borne out by the evidence in this case, petitioner’s dog was his near and dear item which reflected his ultimate change in domicile to Dallas.


Jacquelin Stevenson (Mother) was the sole lifetime beneficiary of two trusts created by the will of her husband, who died in 1988. The residual beneficiaries of the two trusts were her sons, Thomas Stevenson III and Daniel Stevenson II (collectively, the Stevenson brothers), and her daughters, Respondents.

The Stevenson brothers were also co-trustees of the two trusts from 1999 to 2006. Respondents allege that while the Stevenson brothers were co-trustees, they violated their fiduciary duties by unlawfully taking money from the trusts. Respondents claim the Stevenson brothers stole approximately five million dollars from the two trusts.

In 1997, Lynne Kerrison and her accounting firm Dixon Hughes (collectively, Petitioners) began preparing the income tax returns of Mother and the two subject trusts. Mother's personal bookkeeper, Pat Neapolitan, provided Kerrison with the information needed to complete Mother's tax returns and those of the trusts. In 2001, while preparing Mother's tax returns, Kerrison noticed the records reflected loans to one of the Stevenson brothers and had concerns about the propriety of the transactions. She contacted Mother's attorney, Heyward Carter Jr., and informed him of the transactions. In October of 2001, Kerrison, Carter, and the Stevenson brothers met to discuss the suspect transactions. At this meeting, the Stevenson brothers were advised about the impropriety of these transactions, and they were advised to tell Respondents about their actions. Neither Carter nor Kerrison had any discussions with Respondents about Mother's finances or the finances of the trusts. The Stevenson brothers did not tell Respondents about the transactions until a meeting in 2006.

***

In 2006, Respondent Kathleen S. Turner (Turner) attended a meeting with Kerrison, Carter, and the Stevenson brothers. At this meeting, Turner learned for the first time that the Stevenson brothers had withdrawn money from the two trusts over a five year period. Mother passed away in 2007. In 2008, Respondents brought suit against the Stevenson brothers, resulting in a settlement with Thomas Stevenson and a judgment against Daniel Stevenson. In 2009, Respondents filed the present action against Petitioners for professional negligence, breach of fiduciary duty, and aiding and abetting a breach of fiduciary duty.

The opinion goes on to cite federal law with respect to the notification:
Petitioners were prohibited by 26 U.S.C. § 7216 from disclosing the Stevenson brothers' withdrawals to Respondents because this statute prohibits any person who is engaged in the business of preparing tax returns—here, Petitioners—from disclosing to a third party any information furnished for, or in connection with, the preparation of any such return and imposes criminal sanctions for a violation of this prohibition. Respondents contend the “related taxpayer” exception set forth in 26 C.F.R. § 301.7216-2(b)(1)-(2) allowed for disclosure to Turner, as Petitioners also prepared her individual tax returns. We disagree. The exception does not apply, as the exception is triggered only when the tax preparer is engaged in “preparing a tax return of a second taxpayer“ and when the subject information was used in preparing the second taxpayer's returns. 26 C.F.R. § 301.7216-2(b)(1)-(2). While Turner may have been a “second taxpayer,” there is no evidence any information pertaining to the illicit withdrawals was used “in preparing” her personal returns.

Respondents also claim Petitioners should have disclosed the withdrawals to Turner because she was designated as Mother's attorney-in-fact under Mother's 2001 power of attorney. Respondents correctly state that the holder of a power of attorney steps into the shoes of the grantor and is basically the alter ego of the grantor. See Muller v. Bank of Am., N.A., 28 Kan.App.2d 136, 12 P.3d 899, 904 (2000) (citing 3 Am. Jur. 2d, Agency § 23). However, since Kerrison notified Carter, Mother's personal attorney, of the withdrawals, that was sufficient to notify Mother. See Crystal Ice Co. of Columbia, Inc. v. First Colonial Corp., 273 S.C. 306, 309, 257 S.E.2d 496, 497 (1979) (“It is well established that a principal is affected with constructive knowledge of all material facts of which his agent receives notice while acting within the scope of his authority.”). Mother was Carter's client and was competent at the time Kerrison informed Carter about the withdrawals. While Kerrison could have disclosed any information to Turner that was disclosed to Mother through Carter, the power of attorney did not create a separate and independent obligation on the part of Petitioners to disclose the withdrawals to Turner in her capacity as Mother's attorney-in-fact. The fact that disclosure to Turner as attorney-in-fact would have resulted in her being individually aware of the withdrawals is of no import.

The court sent the main aiding and abetting claim to trial:

A. There is Sufficient Evidence to Allow the Aiding and Abetting Claim to Survive Summary Judgment.

In finding Respondents presented sufficient evidence to withstand summary judgment, the court of appeals wrote, “In addition to taking no further action regarding [the Stevenson brothers'] activities, Kerrison's firm actually had possession of the trust checkbooks and wrote the checks for [the Stevenson brothers'] withdrawals of funds from the trusts.” Bennett v. Carter, Op. No. 2015-UP-491. We agree Respondents presented evidence from which a jury could reasonably conclude Petitioners knowingly participated in the Stevenson brothers' breach through Petitioners' possession of the trust checkbooks and writing checks to the Stevenson brothers. However, to the extent the “in addition to taking no further action” language employed by the court of appeals can be interpreted to hold that Petitioners' non-disclosure is evidence of Petitioners' knowing participation, we modify the court of appeals' opinion.
7. **Trust Modification Denied.** A court will not always allow a trust to be modified even if the beneficiaries seek that result. In *Shire v. Unknown/Undiscovered Heirs*, 907 N.W.3d 263 (Ne. 2018) the court refused to modify a trust faced with these facts:

The Trust was created by the last will and testament of Shire, executed on September 10, 1947. Paragraph IV of Shire’s will provided that the Trust would be funded with $125,000 and that the trustees would pay $500 monthly to Shire’s daughter, Ruth Banner Gronin (Ruth), during her life and to Shire’s granddaughter, Gronin, upon Ruth’s death and Gronin’s attaining the age of 25 years. Further, paragraph IV states: “Upon the death of the survivor of [Ruth and Gronin], the balance of the trust fund (including any addition from Paragraph V) shall be added to the residue of my estate and be distributed, as provided in Paragraph VI.”

Gronin was born in 1945. Shire died in 1948. After Ruth passed away in 1983, the monthly $500 payments from the Trust were made to Gronin.

At the time of trial, Gronin was also receiving monthly payments of $564 from Social Security and $88.38 from a casino pension plan. Her total monthly income was $1,152.38. Further, she had two bank accounts, each with a negligible balance. She testified that neither she nor Ruth had ever been able to save any money, because their income never exceeded their living expenses.

A trust officer for Wells Fargo testified that as of September 26, 2016, the Trust had a principal balance of $981,874.58. He further testified that the expected annual return for the Trust, before fees and taxes, ranged from 6.40 percent to 8.10 percent. Consequently, the Trust could expect income and appreciation to be between approximately $64,000 and $81,000 annually. Evidence was also adduced that based on the rate of inflation, the present value of a $500 payment in 1948 would be either $4,997 or $5,400.29 today.

The trial court denied the petition because it would adversely affect future beneficiaries who were unknown. The Nebraska Supreme Court agreed.

There were some beneficiaries before the court:

Before filing the petition, Wells Fargo attempted to identify potential heirs of the beneficiaries identified in paragraph VI of Shire’s will. In its petition, Wells Fargo specifically identified 12 individuals and entities that may have an interest in the residuary and requested the court to notify them of the proceeding. The petition requested that the court determine the beneficiaries under paragraph VI, which was bifurcated from the present proceeding and set for later consideration.

The following known beneficiaries were present at the hearing on the Trust’s modification: six individual beneficiaries participated by counsel, one individual beneficiary participated pro se, and the Nebraska Attorney General’s office participated on behalf of charitable beneficiaries. At Wells Fargo’s request, the court appointed an attorney to represent the “Unknown/Undiscovered Heirs,” if any, of the beneficiaries under paragraph VI of Shire’s will (unknown beneficiaries).
After the hearing, the parties had the opportunity to submit post trial briefs. Counsel for the unknown beneficiaries was the only party that opposed Wells Fargo’s motion. Neither the assistant attorney general nor the pro se beneficiary submitted any brief supporting or opposing the modification of the Trust. Counsel for the six beneficiaries submitted a brief which concluded: “On behalf of our clients, we respectfully request the Court enter an Order adjusting the monthly distribution to ... Gronin consistent with the Trustee’s evidence in such a fashion so as to not jeopardize the corpus of the Trust.” No other beneficiaries expressed consent or an objection.

The obvious problem was the objection of counsel for the unknown beneficiaries. The trustee and other beneficiaries attempted to argue that a modification was allowable anyway but the court refused.

In *Horgan v. Cosden*, 249 So.3d 683 (Fl. App. 2018) the trust involved distributed net income to Christopher Cosden for life with remainder to certain named charities. The opinion states:

Although the Trust does not contain a specific provision prohibiting its early termination, it provides that the balance of the Trust is to be held in a lifetime trust for Cosden's benefit. The net income generated from the Trust principal is to be distributed to Cosden incrementally, at least quarterly. The Settlor named three institutions of higher education to share the principal which would be distributed outright upon Cosden's death. The Settlor included a spendthrift provision which provides that “[t]he income and principal of any trust hereunder shall be used only for the personal benefit of the designated beneficiaries of the trust” and that each beneficiary's interest “shall not be subject to any form of pledge, assignment, sale, attachment, garnishment, execution, or other form of transfer.”

In August of 2015, the income and remainder beneficiaries entered into an agreement to terminate the Trust early and distribute the trust funds according to a calculation of present day value that Cosden prepared. The agreement stated that the value of the Trust was approximately $3,000,000. Cosden's calculation resulted in a distribution where he would receive over $2,000,000 of the principal.

The trustee refused to terminate the trust. The trial court allowed the termination because it would have avoided the expenses of trust administration. The Court of Appeals reversed:

The undisputed facts do not reflect that there has been any waste of Trust assets, that the purposes of the Trust have been fulfilled, or that termination is in the best interest of the beneficiaries when considered in light of the Settlor's intent. The trustees' fees are customary, there is no indication that the administration expenses are unusual, and there has been no invasion of principal. Further, the record does not establish that market fluctuations created a real risk that the Settlor's intent would be thwarted. In essence, the beneficiaries simply prefer a different course of action than that chosen by the Settlor: they want their money now. But on this record, the desire to have the money now would be in direct contravention of the Settlor's intent, including her intent that the income beneficiary would only receive incremental distributions of income rather than a lump sum distribution of principal.

The fact that the Trust does not contain an express provision prohibiting early termination does not mean that the Settlor did not express her intent. She
expressly stated that she wanted her son to have income payments over the course of his life. Many settlors choose to not provide a beneficiary with a lump sum distribution and may not want to spell out the reasons in a trust document. If we were to affirm the trial court's ruling, beneficiaries could have trusts terminated simply by stating that they did not want to pay trustees' fees, administrative expenses, or be concerned with market fluctuations. Nothing in the record indicates that the Settlor was unaware that markets fluctuate. And the Settlor purposefully chose two trustees and was aware of trustees' fees and administration expenses because she provided for them in the Trust.

8. **Legal Practice and Accrual of Claim.** In Frederick v. Wallerich, 907 N.W.2d 167 (MN. 2018), an attorney prepared a prenuptial agreement for a client in 2006. The agreement’s execution was defective because it was not witnessed as required by Minnesota law. In 2007 the same attorney prepared a Will for the client that relied on the prenuptial being effective, and assured the client it was effective. In 2013 client’s wife filed for divorce, arguing that the prenuptial was invalid because it lacked witnesses, and during the divorce action the client filed a legal malpractice action. The statute of limitations was six years; the prenuptial was executed more than six years previously, the Will less. The court held that failing to verify whether the prenuptial was valid could be a separate act of malpractice from the original execution. The opinion states:

In adopting this fact-specific approach to determine when multiple acts are sufficiently distinct to give rise to separate legal-malpractice claims, we also specifically reject the rule proposed by Frederick [client]. Frederick contends that a lawyer owes a professional and fiduciary duty to a client to consult the law and learn the facts “each time” the lawyer provides legal advice to the client. (Emphasis added.) We disagree.

As the amicus Minnesota State Bar Association points out, lawyers must be afforded adequate discretion to make judgment calls when clients seek to revisit previously completed projects. Lawyers must, based on context, discern whether the client simply wants reassurance that the project was completed, a reminder of the outcome, assurance that the outcome was favorable, or additional legal research on the question. We agree with the Minnesota State Bar Association and note that Frederick’s rule is too broad because it assumes that every client, in revisiting previous work, prefers the last option: to have the attorney conduct new research and analysis every time a client asks a question. We therefore reject Frederick’s proposed bright-line rule.

A more fact-specific approach, as we adopt today, permits us to conclude that this subsequent act—a failure to verify the validity of the antenuptial agreement before incorporating it into additional work—may, if proven, give rise to a separate cause of action for negligence. Our ruling today is better suited to the realities of the practice of law and the dynamics of the attorney-client relationship, and leaves room for clients and lawyers to revisit completed projects and re-establish confidence in previous work through a variety of approaches without resulting in additional liability for the attorney.

9. **Divorce Settlement In Which Powerholder Agrees to Certain Exercise of Power of Appointment Ineffective when Powerholder’s Will Exercises Power Differently.** Powerholders often try to bind themselves to exercise a power of appointment in a certain way; if a testamentary power, the powerholder is
generally not bound. In The Trust FBO Samuel Francis DuPont Under Trust Agreement dated August 4, 1936, C.A. No. 12904-MG (Del. Ch. Sep. 25, 2018), the issue was presented in the following context:

The issue is whether a divorce decree incorporating a settlement agreement in which the donee agreed to exercise his power of appointment to benefit the children of his first marriage, bound the donee and the trust, or whether the donee’s last will and testament, which subsequently exercised the donee’s power of appointment to benefit his granddaughter from his second marriage, controls. Beneficiaries of the conflicting appointments filed motions for summary judgment in this case asking the Court to determine which exercise of the donee’s power of appointment dictates. In the alternative, the children of the donee’s first marriage seek a Court finding that the settlement agreement caused a partial release of the donee’s power of appointment so that the trust property passed to them as the takers in default at the time of the divorce, or that the inequitable conduct by the donee and the trustee warrants the imposition of a constructive trust over the trust property.

The opinion relies on the Tigani case:

The Trust and the Settlement Agreement are both governed by Delaware law, and a contract to exercise a testamentary power of appointment is not valid in Delaware. The seminal case addressing this issue is *Estate of Tigani*. After indicating that the question of whether a contract to exercise a testamentary power of appointment is valid appears to be an issue of first impression, then Master LeGrow in *Tigani* concluded that such contracts are not valid, with limited exceptions. She noted that it is presumed that a donor who creates a testamentary power of appointment, or any power that is not presently exercisable, intends that “the selection of the appointees and the determination of the interests they are to receive is to be made in light of the circumstances that exist on the date the power becomes exercisable.” Or, that the “donor essentially requires the donee to ‘wait and see’ and take into account later developing facts before exercising the power.” Therefore, contracting away that power defeats the donor’s intent by eliminating the donee’s ability to change the appointment at any time prior to his death. And, in Delaware, the donor’s intent controls. Further, a contract to exercise a testamentary power of appointment involves a property interest “to which the donee has no claim and . . . cannot dispose of during [his] lifetime.”

In this case, Ernest clearly evidences his intent that Sam could not exercise the power of appointment until his death – or through his last will and testament. The duPons argue that *Tigani* is irrelevant and factually distinguishable because *Tigani* issued in 2016 – 54 years after the Settlement Agreement was incorporated into, and validated, by a court order entitled to full faith and credit. I disagree. The Court’s holding in *Tigani* may have addressed an issue of first impression but it followed long-standing legal principles that were identified in the Herndon Opinion. Those principles emanated from caselaw cited in the Herndon Opinion, much of which predated the 1962 Settlement Agreement. And, since the Trust property remained the donor’s – or Ernest’s, Sam had no property interest that he could bargain away during his lifetime. The duPons failed to show any change in the law or reason why these legal principles, which focus on the primacy of the donor’s intent and were so eloquently explained in *Tigani*, would not also have applied in 1962.
Although the factual circumstances in Tigani may differ, I find the longstanding legal principles that serve as the underpinning for the Tigani holding – that the donor’s intent governs the Trust and if the donor provided for a testamentary LPOA, contracts entered into by the donee concerning the exercise of his LPOA are usually unenforceable because the donee has no rights in trust property to bargain away – control in this case. Sam’s exercise of the LPOA in the Settlement Agreement was legally ineffective because the property he was trying to bind was not his to encumber and the contract to appoint in the Settlement Agreement was not valid and binding on the Trust. But, Sam, in exercising the LPOA contrary to the Settlement Agreement’s provisions through his Last Will, breached that Agreement, even if he had his reasons for doing so. The duPons, as third-party beneficiaries under the Settlement Agreement, could seek restitution from Sam (and Sam’s property) for that breach. Accordingly, I conclude that, consistent with the donor’s intent, Sam’s exercise of the testamentary LPOA in his Last Will in favor of Beck controls the distribution of the Trust property.

10. **Electronic Wills.** In re Estate of Horton, 325 Mich. App. 325 (Mich. App. 2018), the court considered very sad, but simple facts:

The decedent, Duane Francis Horton II, committed suicide in December 2015, at the age of 21. Before he committed suicide, decedent left an undated, handwritten, journal entry. There is no dispute that the journal entry was in decedent’s handwriting. The journal entry stated:

   I am truly sorry about this . . . My final note, my farewell is on my phone. The app should be open. If not look on evernote, “Last Note”[.]

The journal entry also provided an email address and password for “evernote.”

The “farewell” or “last note” referred to in decedent’s journal entry was a typed document that existed only in electronic form. Decedent’s full name was typed at the end of the document. No portion of the document was in decedent’s handwriting. The document contained apologies and personal sentiments directed to specific individuals, religious comments, requests relating to his funeral arrangements, and many self-deprecating comments. The document also contained one full paragraph regarding the distribution of decedent’s property after his death:

   Have my uncle go through my stuff, pick out the stuff that belonged to my dad and/or grandma, and take it. If there is something he doesn’t want, feel free to keep it and do with it what you will. My guns (aside from the shotgun that belonged to my dad) are your’s to do with what you will. Make sure my car goes to Jody if at all possible. If at all possible, make sure that my trust fund goes to my half-sister Shella, and only her. Not my mother. All of my other stuff is you’re to do whatever you want with. I do ask that anything you well, you give 10% of the money to the church, 50% to my sister Shella, and the remaining 40% is your’s to do whatever you want with.

In addition, in a paragraph addressed directly to decedent’s uncle, the note contained the following statement: “Anything that I have that belonged to either Dad, or Grandma, is your’s to claim and do whatever you want with. If there is anything that you don’t want, please make sure Shane and Kara McLean get it.”
In a paragraph addressed to his half-sister, Shella, decedent also stated that “all” of his “money” was hers.

The decedent was under a guardianship and the guardian, Guardianship and Alternatives, Inc. (GAI), offered the Will for probate.

The opinion states:

In this case, it is undisputed that decedent’s typed, electronic note, which was unwitnessed and undated, does not meet either the formal requirements for a will under MCL 700.2502(1) or the requirements of a holographic will under MCL 700.2502(2). Instead, the validity of the will in this case turns on the applicability of MCL 700.2503 and whether the trial court erred by concluding that GAI presented clear and convincing evidence that decedent intended the electronic document to constitute his will.

The court quotes and discusses MCL 700.2503 as follows:

Although a document or writing added upon a document was not executed in compliance with section 2502, the document or writing is treated as if it had been executed in compliance with that section if the proponent of the document or writing establishes by clear and convincing evidence that the decedent intended the document or writing to constitute any of the following:

(a) The decedent’s will.

(b) A partial or complete revocation of the decedent’s will.

(c) An addition to or an alteration of the decedent’s will.

(d) A partial or complete revival of the decedent’s formerly revoked will or of a formerly revoked portion of the decedent’s will.

“The plain language of MCL 700.2503 establishes that it permits the probate of a will that does not meet the requirements of MCL 700.2502.” In re Estate of Attia, 317 Mich App 705, 711; 895 NW2d 564 (2016). Indeed, other than requiring “a document or writing added upon a document,” there are no particular formalities necessary to create a valid will under MCL 700.2503.2 Essentially, under MCL 700.2503, any document or writing can constitute a valid will provided that “the proponent of the document or writing establishes by clear and convincing evidence that the decedent intended the document or writing to constitute . . . [t]he decedent’s will.” MCL 700.2503(a). In considering the decedent’s intent, “EPIC permits the admission of extrinsic evidence in order to determine whether the decedent intended a document to constitute his or her will.” In re Estate of Attia, 317 Mich App at 709. See also MCL 700.2502(3).

The entire “electronic will” issue is controversial. Footnote 5 is interesting in that regard:

5 Jones argues that GAI did not present testimony that anyone saw decedent type the suicide note and that, because it was merely in electronic form, someone else could have typed or altered the suicide note. The trial court
rejected Jones’s argument that the document had been written or altered by someone other than decedent as mere speculation without supporting evidence. Jones does not dispute that the handwritten, journal entry was in decedent’s handwriting. That journal entry directed its finder to decedent’s cell phone. One of the individuals who found and read the electronic note on decedent’s cell phone identified the contents of the note at the hearing. She indicated that she “know[s]” what the notes “says” and that she would “[a]bsolutely” recognize if the note had been changed. The probate court expressly found this witness’s testimony to be credible. Deferring to the trial court assessment of credibility, In re Estate of Erickson, 202 Mich App 329, 331; 508 NW2d 181 (1993), the evidence shows that decedent wrote the electronic note and that it was not altered by anyone else. Contrary to Jones’s arguments, the trial court did not clearly err by concluding that the electronic note was written by decedent.

The Michigan Supreme Court declined to hear the case.

The Uniform Law Commission has approved a uniform electronic wills act. The issues memo for the annual meeting discussion prior to approval states:

This memo provides an introduction to and overview of the Uniform Electronic Wills Act, scheduled for its second and final reading at our 2019 Annual Meeting in Anchorage.

**Background.** In this day and age of digitization, people assume that they can make and execute electronic wills. As a result, with increasing frequency, courts have been asked to validate wills written and “signed” on a tablet in front of witnesses, and unattested wills made in iPhone videos or notes files, or even one consisting of an unsent text message, signed with a smiley face emoji. Given that trillions of dollars of retirement assets pass by beneficiary designations that may be created and signed online, formal will signature and attestation requirements seem outdated and obsolete to many people, so these cases likely will become commonplace.

Commercial providers and remote notary companies have seized on this opportunity. They would like to provide services that would allow people to execute their wills online, eliminating the use of paper and using witnesses and a notary provided by the company. Such companies have drafted and successfully introduced non-uniform legislation in several states which validates electronically signed wills, but also codifies the company’s business model in the statutes. The Uniform Electronic Wills Act, instead, simply allows a testator to execute a will electronically, while maintaining protections for the testator that are available to those executing traditional wills (usually paper), and creates execution requirements that, if followed, will result in a valid “self-proving” will (one admitted without a court hearing to determine validity if no one contests the will).

The Uniform Electronic Wills Act supplies sensible rules and policies for the execution and validity of wills signed electronically on a computer, instead of on paper. It is necessary because while bilateral commercial contracts may be validly signed electronically under the Uniform Electronic Transactions Act (UETA) § 7(a), wills are excluded from its scope under §3(b).
**Key Policies.** The Uniform Electronic Wills Act retains core wills act formalities of writing, signature and attestation, but adapts them. The will must exist in the electronic equivalent of text when it is electronically signed.

The electronic will must be signed in the physical presence of the requisite number of witnesses (normally, two), or, in states that allow it, in their virtual presence. We know that many states oppose attestation by remote (virtually present) witnesses, so the act is designed to make that form of attestation optional and can be easily enacted without that.

While the Uniform Probate Code’s harmless error rule would allow courts to excuse many execution errors, it has been enacted in only eleven states. Given its renewed importance in the era of self-help will drafting, the harmless error rule is included in the Uniform Electronic Wills Act’s Section 6.

The Electronic Wills Act provides that electronic wills, like traditional ones, can be revoked effectively with a revocation document or a subsequent will or codicil. Although it may prove harder to unambiguously revoke an electronic will by physical act, because there can be an infinite number of identical originals, a court will be responsible for determining the intent, which seems adequate protection. The Committee considered not permitting revocation by physical act but realized that many people would assume that they could revoke their wills by deleting them. A requirement that revocation intent be proven by a preponderance of the evidence also avoids the anomaly of requiring more evidence of revocation than is required of proper execution and attestation.

Most traditional wills today are “self-proving”, meaning that the witnesses have not only signed the will, they have also signed an affidavit before a notary public, swearing that the will was properly signed and witnessed. The contents of the self-proving affidavits vary from state to state; the Electronic Wills Act reflects the one in UPC § 2-504. Although the UPC and many non-UPC states permit the affidavit to be signed at any time after the will, the Electronic Wills Act requires that it be executed with an Electronic Will, because doing so means that the self-proving affidavit will be incorporated into the Electronic Will document, itself.

The choice of law and comity provisions of the Electronic Wills Act were perhaps the most discussed and debated ones. Some states object to the remote execution of Electronic Wills, for a number of reasons, perhaps the most common being predictions of abuse by bad actors seeking to take advantage of, or defraud, vulnerable testators. As a practical matter, some states will seek to enforce that “no remote wills” policy by amending their wills acts not only by prohibiting the remote execution of electronic wills in their state, but also by refusing to recognize those that were validly executed out of state, but presented for probate in such a “no remote wills” state.

The Electronic Wills Act, in Section 4, reflects the policy that an electronic will that is valid where the testator was physically located when it was signed should be given effect under that (signing) state’s law. This is consistent with the current law applicable to traditional wills and prevents the intestacy of a testator who validly signs a will while living in a state that permits remote execution, but moves to or just happens to die in a state that prohibits them. This provision would not validate the remotely executed, Nevada will of a testator who signed it while living in a state (say, Connecticut) which prohibits remote execution, if the will is later offered for probate in Connecticut. It would, however, later
require Connecticut to admit the will to probate if it was signed remotely while the testator lived in Nevada, which recognizes such wills.

11. **Quadruplegic Creating Will** Estate of Luce, 2018 WL 5993577 (Tx. App. 2018), dealt with sad, but simple, facts:

The divorce was still ongoing when, on October 11, 2015, Michael was in an ATV accident that left him a quadriplegic. When he was admitted to the hospital immediately after the accident, medical records admitted into evidence at trial revealed that he was alert and oriented as to person, time, and place. Those records also reflected that the accident had not caused any head or brain injuries. Upon admission, Michael told hospital staff that he was going through a divorce and that if he became unable to make his own decisions, he wanted Brandy or Melissa to be his decision makers or, if they were not available, his sister. He made clear that even though he was still married to GayeLynne, he did not want her making any decisions for him.

On the morning of October 18, 2015, Michael—who was still hospitalized—went into respiratory failure and was intubated, leaving him unable to speak. Even so, he was still alert and oriented as to person, place, and time.

Later that day, attorney Kevin Ferrier came to the hospital's intensive-care unit to meet with Michael—who was still intubated and unable to speak—about making a will. Ferrier met with Michael alone and determined Michael's wishes through a series of leading questions that Michael answered by blinking his eyes to indicate “yes” or “no.” Through this system, Ferrier was able to determine that Michael wanted to revoke all prior wills and wanted to leave his entire estate to Melissa and Brandy. Ferrier then went back to his office, drafted the will in accordance with Michael's wishes, and returned to the hospital. He read the will to Michael privately and then read the will to Michael again in front of a notary and two witnesses. In the presence of Ferrier and the witnesses, the notary signed the will for Michael because he was physically unable to sign or make his mark. Then, while still in Michael's presence, the witnesses signed the will and the notary notarized their signatures. Throughout the entire execution process, only Michael, Ferrier, the two witnesses, and the notary were in the hospital room.

The Will was admitted to probate over the objections of GayeLynne, the decedent’s wife. A newly elected probate judge later overturned the original probate judge’s concurrence with the jury. This resulted in both sides appealing; the Court of Appeals upheld the Will.

12. **Punitive Damages Award For Breach of Trust** In Alain Ellis Living Trust v. Harvey D. Ellis Living Trust, 427 P.3d 9 (KS. 2018), father, as trustee of deceased wife/mother’s trust, improperly moved assets to his own trust which had different beneficiaries. The issue before the Kansas Supreme Court was whether punitive damages were allowable. The question turned on the purpose of punitive damages. The opinion states:

K.S.A. 58a-1002, the punitive damages provisions in K.S.A. 60-3702 and 60-3703, and the Kansas survival statute, K.S.A. 60-1801, do not directly answer this question, leaving an ambiguity. But our statutory construction leads us to the conclusion that these statutes, when read together and in conjunction with Kansas common law, reveal a legislative intent to preserve the right to
damages—even those that are penal in nature—after a tortfeasor's death. Thus, we conclude the death of a trustee does not prevent a trial court from allowing a trier of fact to determine whether the estate of a deceased trustee who committed a breach of fiduciary duty and knowingly committed a breach of trust should be liable for (1) punitive damages and (2) statutory damages equal to twice the amount of the property converted when those provide the greater recovery under K.S.A. 58a-1002(a).

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In summary, we do not find any of the arguments asserted by Harvey's Estate to be determinative. And, our review of Kansas law—both as found in statutes and in caselaw—provides no clear resolution of the question of whether an injured party may seek punitive damages from a tortfeasor's estate. We therefore consider the two different approaches adopted in other jurisdictions. See Annot., Claim for Punitive Damages in Tort Action as Surviving Death of Tortfeasor or Person Wronged, 30 A.L.R. 4th 707 (1984).

1.2. Cases from Other Jurisdictions

As we have noted, the first approach, sometimes identified as the majority approach, precludes recovery of punitive damages from a deceased tortfeasor's estate. By one count, when you remove the jurisdictions that have legislatively adopted the majority rule, 14 courts (13 states and the District of Columbia) have adopted this view. This count includes Kansas because a federal court had predicted Kansas would adopt the majority view. See Fehrenbacher v. Quackenbush, 759 F.Supp. 1516 (D. Kan. 1991). In contrast, nine states adopted the minority position by judicial decision. See Comment, Adding Insult to Death: Why Punitive Damages Should Not Be Imposed Against a Deceased Tortfeasor's Estate in Ohio, 49 Akron L. Rev. 553, 564-65 (2016); see also Note, 47 U. Mich. J.L. Reform at 849-51. Virtually all the cases consider the purposes of punitive damages and discuss whether imposing punitive damages on a deceased tortfeasor's estate will further the purposes of punishment and deterrence. See Whetstone v. Binner, 146 Ohio St. 3d 395, 397-98, 57 N.E.3d 1111 (2016) (discussing the different views). So, before discussing those cases, we will review the purposes recognized in Kansas.

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The current statute reflects the continuation of the common-law policies supporting punitive damages as expressed in Kansas cases, including:

“(1) The likelihood at the time of the alleged misconduct that serious harm would arise from the defendant's misconduct;

“(2) the degree of the defendant's awareness of that likelihood;

“(3) the profitability of the defendant's misconduct;

“(4) the duration of the misconduct and any intentional concealment of it;

“(5) the attitude and conduct of the defendant upon discovery of the misconduct;
“(6) the financial condition of the defendant; and

“(7) the total deterrent effect of other damages and punishment imposed upon the defendant as a result of the misconduct, including, but not limited to, compensatory, exemplary and punitive damage awards to persons in situations similar to those of the claimant and the severity of the criminal penalties to which the defendant has been or may be subjected.” (Emphasis added.) K.S.A. 60-3702(b).

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Ultimately, as this review of other jurisdictions shows, how we resolve our case hinges on how we view the purpose or purposes of punitive damages and what we can discern about legislative intent relating to the Kansas statutes. Some jurisdictions, like Iowa, have concluded imposing punitive damages against an estate does not serve the purpose of punishment. We agree with this concept. But we part company with those courts that conclude punitive damages do not serve the purpose of deterring unlawful conduct. The facts of this case suggest the opposite conclusion is warranted.

A trustee who believes the malfeasance can go undiscovered indefinitely, or at least until he or she is no longer alive, would not be restrained if courts could not impose post death punitive damages. And a trustee like Harvey, whose wife had recently died, may have viewed his death as only a matter of time and not some amorphous future inevitability. And the incentive may be even higher if the converted property is of the nature that makes it difficult to calculate actual damages—one of the reasons Alain's Trust argues the double damage provision relates to compensatory, not punitive, damages. But knowing the trustee will have to pay back embezzled or converted assets and face additional, punitive damages may dissuade trustees from engaging in illegal conduct. See Whetstone, 57 N.E.3d at 1115-16; see also Crabtree, 837 N.E.2d at 137-40.

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We also conclude that a trial court can weigh these considerations when deciding whether to allow a motion under K.S.A. 60-3703, and a jury can do so when considering the K.S.A. 60-3702(b) factors. The jury will know the trustee has died and that the party in the suit is his or her estate. Often, that will decrease—if not eliminate—the weight of many of the first six considerations. And that will leave for the jury the consideration of the overall deterrence effect. Weighing all the factors, the jury may determine that punitive damages are not appropriate—just as it did in this case with regard to Gulledge.

Most significantly, however, we discern an intent by the Legislature to allow an injured party to recover the same damages when a tortfeasor is dead as the injured party would recover if the tortfeasor were alive. The intent of the survival statute is best served when an injured party can bring the same cause of action and pursue the same remedies regardless of whether the tortfeasor is alive or dead. In addition, we agree with the reasoning of the Delaware Supreme Court in Gordon, 770 A.2d at 522. It considered determinative the fact its Legislature had stated some exceptions to damage recovery in its survival statute but had not made an exception for deceased tortfeasors. We find it significant the Kansas Legislature created some exceptions to the availability of punitive damages in K.S.A. 60-3702. Like Delaware and other states, we would have to graft another exception onto the statute. The same is true with K.S.A. 58a-1002, which allows punitive damages without exception. In this context, the question
is not whether to allow punitive damages but whether to extinguish damages the Legislature has authorized. And it is not an appropriate role for a court to add those words to any of the Kansas statutes without an indication of legislative intent, especially when doing so would limit a remedy the Kansas Legislature has allowed. See Gray, 306 Kan. at 1294, 403 P.3d 1220 (courts do not generally add words to statutes).

The same considerations applied to a “double damages” provision under the UTC in Kansas:

We next consider the trial court's order granting the motion for partial summary judgment. In granting that motion, the trial court ruled that Alain's Trust could not recover double damages under the KUTC because of Harvey's death. The trial court and the Court of Appeals' panel relied on the rule adopted in other jurisdictions that penal damages do not survive the death of the tortfeasor. Because the issue on which partial summary judgment was granted was one of law and the material facts are undisputed, we review the decision de novo. See Hockett v. The Trees Oil Co., 292 Kan. 213, 219, 251 P.3d 65 (2011).

Alain's Trust argues the trial court failed to apply the plain language of K.S.A. 58a-1002 and, instead, read into the statute a common-law rule that punitive damages do not apply to deceased defendants. Again, subsection (a) of that statute, provides that the trustee is liable for the greater of three measures of damages: (1) the amount necessary to restore the lost value; (2) the trustee's profits, or (3) “if the trustee embezzles or knowingly converts to the trustee's own use any of the personal property of the trust, the trustee shall be liable for double the value of the property so embezzled or converted.” And subsection (c) states that the allowance of those damages “shall not exclude an award of punitive damages.”

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We need not sort through the implications of these various decisions here, however, if our decision that trust beneficiaries may seek punitive damages after a trustee's death applies to the double damage provision. As we have discussed, that decision rests, in part, on the purposes of punitive damages, including the dual penal and deterrence effects. Harvey's Estate presents us with no argument regarding why the penal nature of a double damage award would present reasons we would depart from our analysis of the punitive damage issue.

We have said that double damages—when they are penal in nature—serve the same purposes as do punitive damages. As with punitive damages, this court has observed a long history exists, “‘dating back over 700 years and going forward to today, providing for sanctions of double, treble, or quadruple damages to deter and punish.’” (Emphasis added.) Hayes Sight & Sound, Inc., 281 Kan. at 1315-16, 136 P.3d 428 (quoting State Farm Mut. Automobile Ins. Co. v. Campbell, 538 U.S. 408, 425, 123 S.Ct. 1513, 155 L.Ed.2d 585 [ (2003) ], and citing BMW of North America, Inc. v. Gore, 517 U.S. 559, 581 and n.33, 116 S.Ct. 1589, 134 L.Ed.2d 809 [ (1996) ]).

Thus, assuming the double damage provision of K.S.A. 58a-1002(a)(3) is penal rather than remedial, its penal nature would also serve the purpose of deterring malfeasance. As a result, there is no basis for concluding a different result should apply to the double damage provision than we have reached for punitive damages, especially given that our other reasons for reaching that decision, including our statutory construction, would apply.
We thus hold that the trial court should have allowed Alain's Trust to pursue double damages under K.S.A. 58a-1002 even though the trustee had died. Thus, the trial court erred in granting the partial summary judgment.

13. **Choice of Law Between Filial Support Statutes.** An adult son was in a Pennsylvania care facility and his parents were in New Jersey in the case of *Melmark v. Schutt*, 206 A. 3d 1096 (Pa. 2019). The essence of the issue was set forth by the court as follows:

Melmark suggests Pennsylvania’s filial-support law should be applied instead of New Jersey’s, given the Commonwealth’s interest in ensuring that facilities which care for indigent persons in Pennsylvania are able to look to designated family members to obtain compensation for the provision of essential services. Melmark indicates this interest is especially pronounced here because Alex’s “wealthy parents” “knowingly abandon[ed]” their indigent son “in Pennsylvania with no form of support.” Brief for Appellant at 25, 31. Further, Melmark proffers that all relevant events occurred in Pennsylvania and, as a Pennsylvania non-profit institution, Melmark was entitled to rely on Pennsylvania law when it provided care to Alex. Thus, Melmark argues, even if New Jersey law would otherwise give more protection to Parents than Pennsylvania’s filial support statute for actions occurring in New Jersey, Pennsylvania has a stronger interest in the matter under the present facts.

Melmark also emphasizes that Parents could have moved Alex to a New Jersey facility, where NJ-DDD would have resumed paying for Alex’s care and residence, or continued with their efforts to compel NJ-DDD to pay Melmark. Instead, Melmark argues, Parents took steps, including manipulating the legal systems of both states, to keep Alex in Pennsylvania. According to Melmark, Parents did this because they wanted Melmark to be Alex’s lifelong home where he could live free of charge. Under this scenario, Melmark offers that Pennsylvania’s policy favoring family-supplied compensation for the care of indigent persons should predominate. See id. at 30-42.

Parents counter that New Jersey has the basic responsibility for establishing and regulating the support obligations of its citizens. They suggest that the choice-of-law question should be viewed as solely involving the relationships among family members. See Brief for Appellees at 19-22 (citing *McSwain v. McSwain*, 420 Pa. 86, 215 A.2d 677 (1966) (where an automobile accident involving Pennsylvania citizens occurred in Colorado, applying Pennsylvania law generally precluding interspousal lawsuits, although the suit would have been permitted under Colorado law)). Employing traditional choice-of-law factors, such as which state has the most significant contacts or relation to the action and the protection of justified expectations, Parents emphasize that Parents and Alex were New Jersey citizens at all times and that Parents reasonably expected to be relieved of any obligation to support Alex inasmuch as he was no longer a minor and they were over 55 years old. By contrast, Parents characterize Pennsylvania’s interest in this litigation as less weighty as it solely involves the ability of a private institution to be paid for services rendered.

Parents assert, as well, that requiring them to make support payments under Pennsylvania law, when New Jersey exempts its citizens over the age of 55 from such liability, would violate their equal protection rights. For support, they reference *Pennsylvania, Department of Public Assistance v. Mong*, 117 N.E.2d 32 (Ohio 1954), a dispute in which an indigent father living in Pennsylvania sought support from a son whom he had abandoned while the son was under 16.
years old, and who was living in Ohio at the time of the litigation. Ohio’s statute relieved the son of obligations toward his father due to the abandonment, whereas Pennsylvania’s did not. The court applied Ohio law on the grounds that it would violate equal protection not to allow him to avail himself of Ohio’s protections solely because the father was from Pennsylvania. Parents interpret Mong as indicating that the law of the state where the alleged obligor lives – here, New Jersey – should control. See Brief for Appellees at 26.

The court determined that Pennsylvania law should apply. The opinion states:

We do not deny that New Jersey has a substantial competing interest in fulfilling its policy of exempting parents over 55 years old from support obligations relative to their adult children. In relation to this specific dispute, however, the force of that interest is diminished for two reasons. First, NJ-DDD took steps to ensure that Parents would not have to pay for Alex’s support, as it offered to place Alex in a New Jersey facility at public expense. New Jersey thus acted pursuant to its public policy, and that policy could have been effectuated had Parents accepted NJ-DDD’s offer.

Second, and more important, the course of conduct in which Parents engaged would, by their admission, result in an unrelated private party (Melmark) bearing the cost of providing for their indigent son’s care for the remainder of his life. In this respect, although New Jersey’s welfare laws apparently provide for Alex’s support at public expense, there is no reason to suppose that New Jersey has adopted a public policy favoring imposition of the ongoing cost of care for indigent adults on an unwilling private third party. By contrast, Pennsylvania plainly has a strong interest in ensuring that relatives do not leave their disabled family members at private Pennsylvania facilities in such a way that those facilities are forced to incur substantial uncompensated expenses on an indefinite basis – an interest which is reflected in 23 Pa.C.S. §4603. Under such a scenario, the exemption in New Jersey’s statutory filial support law for parents over 55 years of age cannot justifiably override Pennsylvania’s governing statute – at least for the period from April 1, 2012 to May 15, 2013 – so that the financial burden for Alex’s care falls upon Melmark.

In light of the foregoing, we conclude that Pennsylvania has the stronger interest in applying its law within the framework of this controversy. Accordingly, we will reverse the judgment of the Superior Court insofar as it directed to the contrary, and remand for application of Pennsylvania law as to Count III of the complaint.

14. **Premarital Agreement A Fraudulent Transfer In Community Property State.** In 2005, Robert Sturm got a judgment against Todd Moyer, who had no assets. Periodically, Strum investigated Moyer’s assets. In 2014 Moyer married and signed a prenuptial agreement. The effect of the premarital agreement was at issue in Sturm v. Moyer, 32 Cal. App. 5th 299 (Ca. App. 2019). The opinion describes the agreement as follows:

The premarital agreement provided that each party's earnings and income, and any property acquired during the marriage by each spouse, would be that spouse's separate property; each party acknowledged that these earnings, income, and property otherwise would be community property. The agreement attached as exhibits lists of each party's significant real and personal property and liabilities in which that party currently held an interest; Moyer's list (Exhibit A) included Sturm's judgment against him, as well as several liens and pending...
lawsuits. The agreement also included a kind of sunset provision (paragraph 5.15), which provided that in the event the judgments and liens against Moyer listed in Exhibit A, and any money judgment entered against him during marriage, lapse or otherwise become unenforceable for any reason, the parties' earnings and income, and any assets purchased with those earnings and income, from the date of the marriage will be treated as community property, with certain exceptions. Finally, the premarital agreement included a provision allowing the parties to open a jointly owned checking account to meet their reasonable present and future living expenses, but providing that any property acquired with funds from the account will be owned in the ratio of the respective contributions of each party's separate property into the account; it also expressly stated that the account will not create any community property interest.

The application of the Uniform Fraudulent Transfers Act (UFTA) was discussed as follows:

Having set forth the relevant statutory provisions, we consider whether the UFTA applies to premarital agreements (such as the one at issue here) that make each spouse's earnings, income, and other assets acquired during marriage that spouse's separate property. Resolution turns on two key questions. First, does such an agreement effect a "transfer" under the UFTA? Second, was the agreement intended to "hinder, delay, or defraud any creditor" of the debtor-spouse? The first question is one of law, and can be resolved in this appeal from a demurrer judgment. The second question is one of fact, which cannot be determined on a demurrer or an appeal from a demurrer. We simply note that the complaint alleges sufficient facts to meet the requirement of fraudulent intent, but proof of those facts awaits trial.

Considering the first question, as noted, "transfer" under the UFTA has a broad meaning. It includes "every mode, direct or indirect, absolute or conditional, . . . of disposing of or parting with an asset or an interest in an asset." (Civ. Code, former § 3439.01, subd. (i); currently, Civ. Code, § 3439.01, subd. (m).) Under this definition, there is no doubt that an agreement made during marriage in which a debtor-spouse agrees that the non-debtor-spouse's future earnings, income, or assets would be the non-debtor-spouse's separate property constitutes a transfer because the debtor-spouse is parting with an interest in an asset — the community property represented by the other spouse's earnings — in which he or she has a "present [and] existing . . . interest[.]" (Fam. Code, § 751) during continuance of the marriage. (See State Bd. of Equalization v. Woo (2000) 82 Cal.App.4th 481.)

But what if this same agreement is made in a premarital agreement? Because the parties are not married when the agreement is entered into, the debtor-spouse has no present and existing interest in the community property represented by the non-debtor-spouse's future earnings, income, and assets. Thus, it can be argued (as defendants do here) that no transfer takes place because, by the premarital agreement, the spouses altered the applicability of the community property laws such that neither spouse obtains any interest in community property upon marriage. On the other hand, it can be argued (as Sturm does here) that by law the premarital agreement does not become effective until marriage (Fam. Code, § 1613), at which point two things happen — each spouse obtains a present interest in community property by operation of law (Fam. Code, § 751) and then, by agreement, each spouse transfers to the other his or her community interest in the other's earnings, income, or other property acquired during the marriage.
It might be argued that applying the UFTA to a premarital agreement in which the parties agree that each party's earnings, income, and assets acquired during marriage would be that party's separate property would discourage marriage in cases, such as the present one, in which one of the parties has significant debts while the other party has substantial income. But the Legislature already has provided protection for the couple in such a case, by enacting Family Code section 911. As noted, under that statute, the non-debtor-spouse's earnings are sheltered from liability for the debtor-spouse's premarital debts, so long as those earnings are kept by the non-debtor-spouse in a separate account (to which the debtor-spouse does not have a right of withdrawal) and are not commingled with other property in the community estate. This provision demonstrates, not only an intent to protect the non-debtor-spouse's earnings, but also a policy judgment — an intent to prevent the debtor-spouse from taking advantage of that protection at the expense of his or her creditors by being allowed access to the protected funds.

15. **Child Support vs. Special Needs.** Alexander v. Harris, 2019 WL 2147281 (Fl. App. 2019) dealt with a fascinating policy issue. A father was the beneficiary of a special needs trust established when he was injured in a car accident. He owed about $92,000 in child support. The special needs trust received more monthly than the father's expenses and thus had accumulated about $142,000. Could the $92,000 be paid from the trust. The court held yes stating:

The father argues that using the trust's funds to satisfy his support obligations would jeopardize his eligibility for public assistance under federal law; however, he cannot identify any legal basis for this conclusion. We can find no federal law or regulation expressly addressing the garnishment of a special needs trust to satisfy a support obligation. To the extent that 42 U.S.C. § 1396p discusses support payments and eligibility, subsection (c)(2)(B)(iii) states that "[a]n individual shall not be ineligible for medical assistance by reason of paragraph (1) to the extent that . . . the assets . . . were transferred to . . . the individual's child." Furthermore, federal law gives great deference to state courts in family law proceedings, and the Supreme Court has explained that "[s]tate family and family-property law must do 'major damage' to 'clear and substantial' federal interests before the Supremacy Clause will demand that state law be overridden." Hisquierdo v. Hisquierdo, 439 U.S. 572, 581 (1979) (quoting United States v. Yazell, 382 U.S. 341, 352 (1966)). In Rose v. Rose, 481 U.S. 619, 630 (1987), the Supreme Court recognized that payment of child support is in the parent's best interest, explaining that federal "benefits are not provided to support [the beneficiary] alone." There is no indication in the federal statutes that Congress has expressed any intention to preempt state statutes, like section 736.0503, that permit garnishment of spendthrift trusts to satisfy the child support obligations of the beneficiary. Id. at 628 ("Given the traditional authority of state courts over the issue of child support, their unparalleled familiarity with local economic factors affecting divorced parents and children, and their experience in applying state statutes . . . that do contain detailed support guidelines and established procedures for allocating resources following divorce, we conclude that Congress would surely have been more explicit had it intended the Administrator's apportionment power to displace a state court's power to enforce an order of child support.").
Resolution of this case requires consideration of the equities between these particular parties and resolution of competing public policies related to the enforceability of spendthrift provisions and the payment of support.

On the one hand, there is the long held policy of this state that recognizes the validity of spendthrift trusts. On the other hand, there is the even longer held policy of this state that requires a former spouse or a parent to pay alimony or child support in accordance with court orders.

_Bacardi_, 463 So. 2d at 221. Where the two conflict, this court has held that Florida's public policy favoring enforcement of support orders takes precedence. _Berlinger_, 133 - 6 - So. 3d at 966 ("Florida has a public policy favoring spendthrift provisions in trusts and protecting a beneficiary's trust income; however it gives way to Florida's strong public policy favoring enforcement of alimony and support orders."). Thus, although the trial court correctly recognized the compelling equitable interests of the parties in this case, we must nevertheless reverse. The special needs trust does not protect the father from his legal obligation to support his child. A continuing writ of garnishment is appropriate in this case, and the court may limit the award to such relief as is appropriate under the circumstances. See § 736.0503(3).

16. **Trusts and Medicaid Benefits.** Spousal trusts and Medicaid eligibility were before the Michigan’s Supreme Court in _Hegadorn v. Department of Human Services Director_, 2019 WL 2064530 (Mi. 2019).

The facts were:

In these consolidated cases, the individual plaintiffs were elderly women receiving long-term care in nursing homes. In each case, the plaintiff, an “institutionalized spouse,” began receiving long-term care at a nursing home at her own expense. One to two months later, each plaintiff’s husband, a “community spouse,” created an irrevocable trust that was solely for his own benefit. Such a trust is commonly called a “solely for the benefit of,” or “SBO,” trust. The couples then transferred a majority of their individual and marital property to each SBO trust or its trustee, giving up any claim of title to that property. Distributions or payments from each SBO trust were to be made on an actuarially sound basis and solely to or for the benefit of the community spouse. The actuarially sound distribution schedule required that each trustee distribute the income and resources held by the trust to each community spouse at a rate that would deplete the trust within the community spouse’s expected lifetime. A short time after each SBO trust was formed, each institutionalized spouse applied for Medicaid benefits. The Department of Health and Human Services and its director (collectively, the Department) determined that the entire value of the principal of each SBO trust was a countable asset for the purpose of determining each institutionalized spouse’s eligibility for Medicaid benefits. Thus, the Department concluded that each institutionalized spouse did not show the requisite financial need because the value of the trust assets put their countable resources above the monetary threshold, and it denied each application.

In each case, the plaintiff unsuccessfully contested the Department’s decision in an administrative appeal, but each decision was then reversed on appeal in the circuit court. On appeal in the Court of Appeals, all three cases were consolidated, and the Department’s denial decisions were reinstated in a published opinion.
With the cases having been appealed in this Court, we conclude that the Court of Appeals erred in its interpretation of the controlling federal statutes, which caused the Court of Appeals to improperly reinstate the Department’s denial decisions. As explained in this opinion, the fact that an irrevocable trust, which includes former assets of an institutionalized spouse, can make payments to a community spouse does not automatically render the assets held by the trust countable for the purpose of an institutionalized spouse’s initial eligibility determination. See 42 U.S.C. 1396p(d)(3)(B); 42 U.S.C. 1396r-5(c)(2). Accordingly, we reverse the judgment of the Court of Appeals. Because the administrative hearing decision in each case suffered from the same faulty reasoning used by the Court of Appeals, this legal error may have caused the administrative law judges (ALJs) to forgo a more thorough review of the Medicaid applications at issue or to disregard other avenues of legal analysis. Therefore, rather than order that the Medicaid applications be approved at this time, we vacate the hearing decision of the ALJ in each case and remand these cases to the appropriate administrative tribunal for any additional proceedings necessary to determine the validity of the Department’s decision to deny plaintiffs’ Medicaid applications.

The opinion notes that the trust rules are complicated:

Once it is determined that a Medicaid applicant has established a trust, the question becomes whether assets held by the trust are available to the applicant. The trust rules in 42 U.S.C. 1396p(d)(3) treat revocable trusts and irrevocable trusts differently. Generally, the principal of a revocable trust is always considered an asset available to the Medicaid applicant who formed the trust. See 42 U.S.C. 1396p(d)(3). This is unsurprising, as a trustor can typically dissolve a revocable trust and reclaim title and possession of those things held by the trust.

The rules for irrevocable trusts are more intricate. Notably, the rules do not assume that assets placed in an irrevocable trust are available to the Medicaid applicant. Instead, when assessing an irrevocable trust, the “any-circumstances rule” applies:

(i) if there are any circumstances under which payment from the trust could be made to or for the benefit of the individual, the portion of the corpus from which, or the income on the corpus from which, payment to the individual could be made shall be considered resources available to the individual, and payments from that portion of the corpus or income—

(I) to or for the benefit of the individual, shall be considered income of the individual, and

(II) for any other purpose, shall be considered a transfer of assets by the individual subject to subsection (c); and

(ii) any portion of the trust from which, or any income on the corpus from which, no payment could under any circumstances be made to the individual shall be considered, as of the date of establishment of the trust (or, if later, the date on which payment to the individual was foreclosed) to be assets disposed by the individual for purposes of subsection (c), and the value of the trust shall be determined for purposes of such subsection by including the amount of any payments
made from such portion of the trust after such date. [42 U.S.C. 1396p(d)(3)(B) (emphasis added).]

The crucial issue is who is “the individual:”

Correctly applying the any-circumstances rule requires understanding to whom “the individual” refers in 42 U.S.C. 1396p(d)(3)(B). The Department urges us to read “the individual” as referring to anyone whose resources must be evaluated in assessing a Medicaid application, without regard to whether that person is the Medicaid applicant or the applicant’s spouse. Applied here, the Department reads “the individual” as referring to the person applying for Medicaid benefits (the institutionalized spouse), the community spouse, or both. This was also the meaning adopted by the Court of Appeals. However, we conclude that this interpretation suffers from several critical flaws.

As already discussed, the context in which a statutory term is used affects its meaning. See South Dearborn, 502 Mich. at 361, 917 N.W.2d 603. As with Paragraphs (1) and (2) of 42 U.S.C. 1396p(d), the context in which “the individual” is used limits the scope of possible human beings to which 42 U.S.C. 1396p(d)(3)(B) refers. The first limitation is the use of the definite article “the” preceding “individual.” This suggests that “the individual” referred to in 42 U.S.C. 1396p(d)(3)(B)(i) is a single person, as opposed to an open class of all people. See Massey v. Mandell, 462 Mich. 375, 382 n. 5, 614 N.W.2d 70 (2000) (“ ‘The’ and ‘a’ have different meanings. ‘The’ is defined as ‘definite article. 1. (used, [especially] before a noun, with a specifying or particularizing effect, as opposed to the indefinite or generalizing force of the indefinite article a or an) ....’ Random House Webster’s College Dictionary, p. 1382.”).

Additionally, Paragraph (1) of Subsection (d) begins by stating, “[f]or purposes of determining an individual’s eligibility for, or amount of,” Medicaid benefits, “the rules specified in paragraph (3) shall apply to a trust established by such individual,” 42 U.S.C. 1396p(d)(1) (emphasis added). As discussed in Part III(B)(2) of this opinion, Paragraph (1) uses “an individual” to refer to a person applying for Medicaid benefits or a person who qualifies for benefits, but the amount of those benefits must be determined.19 Paragraph (1) then states that Paragraph (3) applies to a trust established by that applicant or recipient. Thus, while “an individual” in Paragraph (1) can be read as referring to a potential class of persons, when “such individual” establishes a trust, that class is reduced to a single person for the purposes of Paragraph (3). Paragraph (2) of Subsection (d) also refers to “an individual” when describing whether such individual established a trust, and it contrasts that term with “the individual’s spouse.” 42 U.S.C. 1396p(d)(2)(A)(i) and (ii).

Reading these provisions together, it follows that when Paragraph (3) refers to “the individual,” it is referring to the same individual whose eligibility for, or amount of, benefits is being determined and who has established a trust under Paragraph (2): the applicant for or recipient of Medicaid benefits. When considering the eligibility of an institutionalized spouse for Medicaid benefits, “the individual” must be read as referring to the institutionalized spouse to the exclusion of the community spouse, who, by definition, is not applying for or receiving Medicaid benefits.

Accordingly, that only a spouse may receive benefits does not affect Medicaid eligibility:
Neither 42 U.S.C. 1396r-5 nor 42 U.S.C. 1396p(d) automatically makes marital assets placed in an irrevocable trust for the sole benefit of a community spouse countable assets for the purpose of an institutionalized spouse’s initial eligibility determination. Rather, such assets become countable only if circumstances exist under which the trust could make a payment to or for the benefit of the institutionalized spouse. Accordingly, we reverse the judgment of the Court of Appeals.

A concurrence wanted to limit the planning opportunities of the opinion. It states:

The plaintiffs applied for Medicaid to help defray the costs of nursing-home services. That’s what Medicaid is for, but eligibility for its financial assistance is means-tested. To satisfy Medicaid’s income and resource limits while preserving their assets, the plaintiffs each formed and funded an irrevocable “solely for the benefit of” (SBO) trust. The critical feature of these SBO trusts is that during each plaintiff’s spouse’s lifetime, distributions from the trusts could be made only to that spouse. I agree with the majority that property held in these SBO trusts is not countable toward Medicaid’s resource limit because “the individual” in 42 U.S.C. 1396p(d)(3)(B) refers to the Medicaid applicant.

But I also believe that the plaintiffs’ transfer of assets into the trusts triggers Medicaid’s divestment rules. This issue has not been presented here, for understandable procedural reasons. I believe such a discussion is necessary, however, as a caution. If I am correct, then the plaintiffs’ overall planning strategy would be undermined: although they would be able to satisfy Medicaid’s threshold resource test, the plaintiffs would be disqualified from receiving Medicaid benefits for a time period calculated by reference to the value of the transferred assets. And because their strategy involves irrevocable trusts, there is no way to unwind the transfer. In short, the majority opinion should not be interpreted as permitting a married Medicaid applicant to shelter and preserve any amount of wealth without restriction, and then immediately receive financial assistance as if she did not have it.

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The plaintiffs’ Medicaid planning strategy—SBO trusts—implicates the general rules for irrevocable trusts at 42 U.S.C. 1396p(d)(3)(B). As the majority explains, any property held in an SBO trust is not an available “resource” of the married couple for purposes of Medicaid’s financial eligibility determination, because the trust is irrevocable and legal title is held by the third-party trustee; the trust property is therefore not countable, because it “is not held by either spouse.” And because the terms of these SBO trusts require that any distribution be made to the plaintiffs’ spouses (the community spouses) for the spouses’ lifetimes, there can never be “any circumstances under which payment from the [SBO] trust could be made to or for the benefit of” these plaintiffs. 42 U.S.C. 1396p(d)(3)(B)(i).

Normally, such a transfer would trigger the divestment penalty, as the property held in trust is “assets disposed by the [institutionalized] individual for purposes of” the transfer rules. 42 U.S.C. 1396p(d)(3)(B)(ii). But according to the plaintiffs, the transfer of marital assets into these SBO trusts are exempt from the divestment penalty, because they are transfers to a third party (the trusts) “for the sole benefit of” the community spouse. See 42 U.S.C. 1396p(c)(2)(B)(i) and (ii). In short, the plaintiffs’ theory is that an institutionalized individual can achieve immediate (penalty-free) eligibility for Medicaid financial assistance by
simply placing any assets over the eligibility limit in an irrevocable trust, and also avoid the divestment penalty that accompanies that kind of divestment, so long as any payments from the trust are made only to the community spouse during his lifetime.

The result: a perfect loophole to Congress’s carefully constructed eligibility and transfer rules.

17. **Equitable Adoption Possible in District of Columbia.** An individual who was neither biological nor a legally adopted child of woman, who died intestate, moved to appoint a personal representative and asked court to recognize his right to inherit as an equitably-adopted child in *In re Estate of North Ford* (200 A.3d 1207 (DC App. 2019). The court held:

> With this exposition of our thinking, we conclude that if an individual seeks to establish that he is an intestate decedent's child and heir as a matter of equity, he must prove that the decedent objectively and subjectively stood in the shoes of his parent. At a minimum, the putative child must prove that, as a minor, the decedent gave him a permanent home. Further, the court should consider the particular facts regarding the nature of the decedent's relationship with the putative child, including but not limited to whether the decedent cared for the putative child (i.e., took charge of his health, education, and general welfare) until he reached the age of majority, as a parent would; whether the putative child was incorporated into the decedent's broader family; whether the decedent gave the putative child her surname; and whether the decedent held herself out to others in the community as a parent to the putative child. The court may also consider whether the putative child continued to maintain a relationship with his biological family and if so, if that relationship was inconsistent with the decedent assuming the role of parent to the putative child.

We intentionally set a high substantive bar—one that we anticipate will be difficult if not impossible for individuals younger than Mr. North-Bey to surpass. Our highly-regulated foster care and adoption systems now leave little room for doubt about the creation—or not—of a parent-child relationship. But we cannot say that this has always been the case in the District of Columbia. Certainly, the facts proffered by Mr. North-Bey to the trial court suggest a very different era, where parent-child relationships could have formed extra legally. And it is these proffered facts that persuade us that the identification of an intestate decedent's child and heir under the District's intestacy statutes may be subject to equitable interpretation.

We further hold that an individual who seeks to establish that he was functionally the decedent's child under the intestacy statute must support his claim by clear and convincing evidence.20

The opinion notes various positions of different states. Some states simply say that there is no equitable relief from the intestacy statues. However:

unnecessary fiction”). These states require an individual claiming “child” status to prove the existence of an unperformed contract or agreement to adopt. But this diverts the inquiry from discerning to whom the decedent would have wanted to distribute her property to examining whether a contract was formed.

A third group of states more generally seeks to promote fairness and to honor the intent of the decedent to treat a child as if the child were the decedent's own. See, e.g., In re Ford, 8 Cal.Rptr.3d 541, 82 P.3d at 754; DeHart v. DeHart, 369 Ill.Dec. 136, 986 N.E.2d 85, 103 (Ill. 2013); Wheeling Dollar Sav. & Tr. Co., 250 S.E.2d at 372, 373. We align ourselves with these states' focus on the decedent's intent and examination of whether the claimant was functionally the decedent's child. This approach, however, appears to be less the stuff of distinct doctrine and more the traditional practice of considering what is equitable in light of the particular facts of the case.

18. **Land Not Owned By A Trust.** In Homan v. Estate of Homan, 121 N.E.3d 1104 (In. App. 2019), a revocable trust discussed a farm but the farm was neither deeded to the trust not listed on Schedule A as a trust asset. The opinion states:

Initially, we note that, in addition to leaving Schedule “A” blank, Robert never executed a deed transferring the farm land to the trust. Paul asserts that this fact, alone, is enough to establish that the farm land is not trust property. He cites Indiana Code section 32-21-1-13, which provides that, generally, “a conveyance of land or of any interest in land shall be made by a deed that is: (1) written; and (2) subscribed, sealed, and acknowledged by the grantor (as defined in IC 32-17-1-1) or by the grantor's attorney.” But as our Supreme Court has explained, “‘If the owner of property declares himself trustee of the property, a trust may be created without a transfer of title to the property.’ ” Hinds v. McNair, 235 Ind. 34, 52, 129 N.E.2d 553, 563-64 (1955) (quoting Restatement (First) of Trusts § 17 cmt. a (Am. Law Inst. 1935)); see also Kesling v. Kesling, 967 N.E.2d 66, 79 (Ind. Ct. App. 2012), trans. denied. In other words, while a separate deed could certainly provide clarity, a written trust instrument can satisfy the written-deed requirement. See, e.g., Restatement (Third) of Trusts § 10 (Am. Law Inst. 2003); Rose v. Waldrip, 316 Ga.App. 812, 730 S.E.2d 529 (2012); Ladd v. Ladd, 323 S.W.3d 772 (Ky. Ct. App. 2010); Estate of Heggstad, 16 Cal. App. 4th 943, 20 Cal.Rptr.2d 433 (1993).

The question we must address is whether the trust agreement was sufficient to make the farm land property of the trust. We hold that it was not. Indiana’s Trust Code defines “trust property” as “property either placed in trust or purchased or otherwise acquired by the trustee for the trust regardless of whether the trust property is titled in the name of the trustee or the name of the trust.” Ind. Code § 30-4-1-2(22). One way for property to be “placed in trust” is “a declaration by an owner of property that he or she holds that property as trustee for one or more persons[,]” Restatement (Third) of Trusts § 10. Here, the trust agreement includes the framework for such a declaration when it says, “The GRANTOR hereby transfers to himself as TRUSTEE the property listed on the attached Schedule, marked Schedule ‘A’, and incorporated herein.” However, because Schedule “A” was left blank, it cannot be said that Robert “declared” himself trustee of the farm land or any other property.
John directs us to Indiana Code section 30-4-2-1(b), which provides, in part, that “no formal language is required to create a trust, but the terms of the trust must be sufficiently definite so that the trust property ... may be ascertained with reasonable certainty.” John contends that, despite the blank Schedule “A”, the property Robert “intended to be trust property can be ‘ascertained with reasonable certainty’ ” because the farm land is discussed in the distribution section of the trust agreement. Appellant's Br. p. 27. He emphasizes the provision that he (as successor trustee) “will continue the farm operation, held in trust ....” Appellant's App. Vol. II p. 47. Judging by this language, it may be that Robert intended to place the farm land into the trust and simply neglected to complete Schedule “A.” But in determining whether property meets the definition of “trust property” under Indiana Code section 30-4-1-2(22), the question is not whether the owner “intended” to place the property in trust but whether the property was, actually, “placed in trust.” Here, neither the farm land nor any other property was “placed in trust.”

19. Suicide a Breach of Marital Settlement. Timothy Woytas was divorced and agreed to maintain certain life insurance policies payable to his former wife and children. The policies contained a two year suicide exclusion. Mr. Woytas committed suicide within two years. The court held that he breached his settlement agreement. Because of the dollars involved, the remedy was to award all of the estate assets to the former spouse and children. Woytas v. Greenwood Tree Experts, Inc., 206 A.3d 386 (N.J. 2019).

20. Spendthrift Clause Ensured Trust Was Solely Wife’s. In Amy Levitan v. Daniel J. Rosen, 2019 WL 1984750 (Ma. App. 2019), a discretionary trust over which the wife also had a 5% withdrawal right, was allocated entirely to the wife’s share. The opinion states:

Here, the wife's share of the trust vested upon the death of her father in 2007. However, as discussed above, the wife's entire share is governed by the trust's spendthrift provision. In ruling that the spendthrift-controlled portion of the wife's share was a mere expectancy rather than a marital asset under § 34, the trial judge emphasized the absence of an “ascertainable standard” guiding the trustee's exercise of discretion. See Pfannenstiehl, 475 Mass. at 113, 55 N.E.3d 933 (“‘ascertainable standard’ ... limits the discretion of the trustee, who is obligated to make distributions with an eye toward maintaining the beneficiary's standard of living in existence at the time the trust was created”).

However, the mere fact that a trustee's discretion is “uncontrolled” (i.e., not governed by an ascertainable standard) does not necessarily preclude a trust's inclusion in the marital estate. See Davidson v. Davidson, 19 Mass. App. Ct. 364, 371-372, 474 N.E.2d 1137 (1985). Indeed, in Pfannenstiehl, supra at 113-115, 55 N.E.3d 933, the inquiry did not turn on whether the trust contained an ascertainable standard. Rather, the Supreme Judicial Court held that the husband's interest in a discretionary trust was a mere expectancy because the class of beneficiaries was open (rendering the husband's one-eleventh interest susceptible to future reduction), and the trust was clearly intended to benefit multiple generations. Id. Similarly, in D.L., 61 Mass. App. Ct. at 497, 811 N.E.2d 1013, we held that the husband's beneficial interest in a discretionary trust was not includable under § 34 because “payments from principal to the beneficiaries [were] to be made, if at all, in the ‘uncontrolled’ discretion of the trustees,” “in the thirty-eight year history of the trust, there ha[d] never been a distribution of principal from the trust to the husband,” and the trust “[wa][s] generational in nature,” designed to “benefit the long-term (not near term) needs
of the beneficiaries” (which included “not only the husband but his issue and [their] spouses”).

Here, by contrast, the wife's share of the trust is not susceptible to reduction (as she is the sole beneficiary of her share presently held in trust), the beneficiary class is closed, and the “primary intent” of the trust is to provide for the wife rather than for subsequent generations. Accordingly, the wife's trust interest in this case is sufficiently distinguishable from those deemed mere expectancies in Pfannenstiehl and D.L. Moreover, though the independent trustee's discretion is not guided by an ascertainable standard, there is some degree of predictability built into the trust by virtue of the wife's annual right to withdraw five percent of the trust principal, albeit subject to the spendthrift provision.  

We therefore conclude that the wife's trust interest may properly be considered an asset subject to equitable distribution under § 34. See S.L. v. R.L., 55 Mass. App. Ct. 880, 883-884 & n.10, 774 N.E.2d 1179 (2002) (wife's one-fifth remainder interests in four trusts were includable in marital estate, as remaindermen classes were fixed for those trusts); Comins v. Comins, 33 Mass. App. Ct. 28, 30, 595 N.E.2d 804 (1992) (wife's vested beneficial interest in discretionary trust with closed beneficiary class was includable in marital estate); Davidson, 19 Mass. App. Ct. at 371-372, 474 N.E.2d 1137 (husband's remainder interest in father's testamentary trust, which granted trustees “uncontrolled discretion” and contained spendthrift provision, was part of marital estate because husband's remainder interest was fixed at time of father's death, despite that value of interest was uncertain). See also Lauricella, 409 Mass. at 216-217, 565 N.E.2d 436 (husband's vested, one-half beneficial interest in trust was includable under § 34 as husband occupied two-family house owned by trust, beneficiary class was closed, and husband only had to outlive trust's natural termination date to receive share of trust property). Because the judge here did not include the wife's entire trust share in the marital estate when assigning property under § 34, the portion of the divorce judgment pertaining to property division must be vacated and remanded. Though the wife's share of the trust is includable in the marital estate, it may only be assigned to the wife in light of the spendthrift provision. Accordingly, the wife's trust share shall be distributed exclusively to the wife, and the distribution of the remaining marital assets is left to the judge's discretion after considering the relevant § 34 factors on remand. See Davidson, supra at 373, 474 N.E.2d 1137.

The amount of the 5% withdrawal right did count for child support calculation purposes.

21. **Non-Charitable Pledge Could Be Enforced on Promissory Estoppel Theory.** A country club sued an estate to enforce a pledge for golf course improvements. Because it wasn’t a charity, the court would not find a contract but could apply promissory estoppel. In In re Estate of Ryan, 302 Neb. 821 (Neb. 2019), the opinion states:

Typically, a promise to make a gift in the future is not legally enforceable. Long ago, this court recognized that a promise to make a gift in the future is ordinarily unenforceable, even when put in the form of a promissory note. But in charitable giving cases, courts frequently find such future promises to be enforceable as a pledge or subscription. “A ‘subscription contract’ or ‘subscription,’ as it is often called, is not a gift, but is a contract, oral or written, by which one engages to contribute a sum of money for a designated purpose, gratuitously, as in the case of subscribing to a charity.”
Here, Shadow Ridge sought to have the pledge agreement enforced as a contract. A contract requires an offer, acceptance, and consideration. The general rule is that a subscription to a charitable or other institution must be supported by a consideration in order to be a binding obligation. But an action on a note given to a church, college, or other like institution, upon the faith of which money has been expended or obligations incurred, generally cannot be successfully defended on the ground of lack of consideration. In such cases, although the note is characterized as a gift or donation, the expenditure of money or assumption of liability by the donee in reliance on the promise constitutes a valuable and sufficient consideration.

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We conclude that the absence of cases enforcing pledge agreements in favor of profitmaking entities is not mere happenstance. “[F]rom early times academies, colleges, missionary enterprises, churches, and other similar institutions for the public welfare, have been established and often maintained upon private donations and subscriptions.” Some early cases advanced the view that “a subscription to charity was purely gratuitous,—a nudum pactum, not enforceable at law,—and performance was left to the conscience and honor of the subscriber.” But many courts, including this court, began to enforce eleemosynary subscriptions. This change flowed from a commendable regard for public policy and a desire to give stability and security to institutions dependent on charitable gifts.

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Shadow Ridge alternatively alleged that its claim should be granted under a promissory estoppel theory. Recovery on a theory of promissory estoppel is based upon the principle that injustice can be avoided only by enforcement of a promise. Under the doctrine of promissory estoppel, a promise which the promisor should reasonably expect to induce action or forbearance is binding if injustice can be avoided only by enforcement of the promise.

Under Nebraska law, the doctrine of promissory estoppel does not require that the promise giving rise to the cause of action must meet the requirements of an offer that would ripen into a contract if accepted by the promisee. Under this theory, the main focus is on reasonable reliance. And here, we are reviewing only a dismissal for failure to state a claim.

22. **Meaning of Charitable Beneficiary Being in Existence at Death.** In Sibley v. Estate of Sibley, 2019 WL 1461325 (Fla. App. 3d, 2019), a trust provided as follows:

All remaining trust estate to the Settlor's charitable foundation, the CURTISS F. SIBLEY CHARITABLE FOUNDATION. If the [Foundation] is no longer in existence upon the Settlor's death, then the Trustee shall distribute all of the remaining trust estate to the FELLOWSHIP HOUSE FOUNDATION of South Miami, Florida.

(Emphasis added)
At the decedent’s death, the Sibling Charitable Foundation had been administratively dissolved. Of course, as the court notes, an administration dissolution can be easily corrected. What effect does that have? The opinion states:

Additionally, Charles contends that because the Foundation was reinstated ten months after it was administratively dissolved (and seven months after Curtiss' death), the trial court erred in not relating back the reinstatement to the date of the administrative dissolution, thereby treating the Foundation as if it had never been administratively dissolved. Charles relies for this proposition on section 607.1422, Florida Statutes (2011), which provides in pertinent part:

(1) A corporation administratively dissolved under s. 607.1421 may apply to the Department of State for reinstatement at any time after the effective date of dissolution. The corporation must submit a reinstatement form prescribed and furnished by the Department of State or a current uniform business report signed by the registered agent and an officer or director and all fees then owed by the corporation, computed at the rate provided by law at the time the corporation applies for reinstatement.

(2) If the Department of State determines that the application contains the information required by subsection (1) and that the information is correct, it shall reinstate the corporation.

(3) When the reinstatement is effective, it relates back to and takes effect as of the effective date of the administrative dissolution and the corporation resumes carrying on its business as if the administrative dissolution had never occurred.

(Emphasis added.)

However, we hold that this statutory provision does not apply to the issue presented here: a determination of whether, at a fixed point in time (the date of Curtiss' death), the Foundation “was no longer in existence” as instructed by the Trust's time-certain testamentary provision.

Were we to apply the relation-back provision of section 607.1422 to the instant circumstance, as urged by Charles, the administration of an estate might never achieve finality, because an administratively dissolved beneficiary might (at some unknown point in the future) be reinstated and seek application of the relation-back provision to establish its nunc pro tunc existence. As Fellowship House aptly noted in its brief: “To assume the ability to perpetually reinstate the Foundation by [Charles] (or anyone else for that matter) after the death of Curtiss renders meaningless the testamentary instruction, as the Foundation could, quite possibly, always be in existence as long [as] someone prospectively filed the necessary annual reports and paid the delinquent fees.”

23. Domestic Partner Has No Rights in Alaska. A long-time unmarried domestic partner had no property rights as determined in Matter of Estate of Hatten, 440 P.3d 256 (Ak. 2019). The facts were straightforward:
Jerry Hatten and Beverly Toland met in California in 1989. Hatten, who lived in Alaska, returned to California in 1992 and reconnected with Toland. According to Toland, Hatten asked her to leave her job, friends, and family behind to live with him in Kasilof. Hatten purportedly assured her that if she relocated “he would take care of [her]” and that she “wouldn’t have to work.” Toland agreed, and she moved into the house that she would occupy with Hatten for over 20 years.

Hatten was a commercial fisherman and paid for most of the couple’s shared expenses. Toland worked at various jobs, first at a grocery store, then at a cannery, and later as a bartender. She also saw to domestic chores, such as cooking and cleaning. According to Toland, neither she nor Hatten had any other romantic partners, there was never any period of physical separation between them, and they shared a bed until the final years of Hatten’s life, when he was experiencing discomfort from various ailments and opted to sleep on the couch.

Neither Toland nor Hatten wanted to formally marry; each had previous marriages ending in divorce. Hatten’s and Toland’s financial and legal affairs consequently were less intertwined than their shared daily life. They had two joint credit cards, but they maintained separate checking accounts. Most significantly, Hatten exclusively owned the house they lived in.

Hatten built the house in 1978 and paid off the building loan shortly after Toland’s arrival in Alaska. In 1998 he obtained a loan to purchase the leased land where he had built the house, and he subsequently paid off that loan around 2007. A 1998 appraisal valued the property at $190,800. Toland did not contribute to the loan payments nor was she listed on utility accounts, which Hatten paid. At no time did Hatten grant title to Toland. Hatten has two adult children from his previous marriage, a daughter and a son. Although Hatten’s daughter had for some time lived outside his home, it remained a primary residence for his son, who is physically disabled.

Toland gave Hatten a will kit five years before his death. Hatten suffered from chronic obstructive pulmonary disorder, and when he battled pneumonia in January 2013 his friends and family asked how he planned to take care of his estate and urged him to create a will. In February Hatten named Toland the sole beneficiary of his $194,000 Edward Jones IRA account. The beneficiary designation form lists Toland’s relationship to Hatten as “Domestic Partner.” A month later Hatten suffered a heart attack and died. He left no will.

Alaska case-law may allow the division of property when domestic partners break-up while living, using a partnership theory, but no such theory is applicable at death:

Alaska has distinct property division schemes that apply depending on when a relationship ends. If a marriage ends during the lifetimes of the spouses, courts apply statutory marital property principles and equitably distribute the spouses’ property. During the marriage, spouses do not gain a present property interest in marital property simply by virtue of their relationship; that interest vests only at divorce. If a domestic partnership ends during the lifetimes of the partners, no specific statutes control the distribution of partnership property. This court instead has formulated a common law analysis to distribute the partnership property according to the partners’ shared intent. This partnership property interest, like a marital property interest, vests only at the dissolution of the partnership.
If a relationship ends at the death of one member, Alaska’s probate code comprehensively governs the rights of both surviving spouses and domestic partners. A surviving spouse takes all, or most, of a deceased spouse’s intestate estate; a surviving spouse who is dissatisfied with a deceased spouse’s will can choose to receive a statutory elective share of the deceased’s augmented estate. A surviving domestic partner, in contrast, inherits none of a deceased partner’s estate under the probate code. And, unlike in the case of an inter vivos separation, the probate code has provisions disposing of all of a deceased partner’s estate, whether the partner died testate or intestate. There is no “gap” to fill with a common law scheme that would distribute the deceased partner’s property according to the partners’ shared intent. If the deceased partner did not provide for the surviving partner through a will, the surviving partner will not inherit the deceased’s property as a testamentary matter.

The court refused to follow Washington law because it is a community property state:

Toland argues that this court should follow the Washington Supreme Court’s decision in Olver v. Fowler and apply the same property division scheme to all domestic partnership separations regardless of when they occur. She contends that, consistent with Olver, this court should hold that domestic partnership property interests vest when the partners have the requisite intent. But Toland ignores a key distinguishing feature — Washington is a community property state, and spouses acquire “a present, undivided interest in the couple’s community property.” Domestic partners in Washington acquire a similar interest “by analogy.” It follows then that, at the death of one partner in Washington, the surviving partner is entitled to retain the property interests properly acquired during the parties’ lifetimes — even if that property is titled in the deceased partner’s name alone. In Alaska spouses and domestic partners do not gain a present property interest in separately titled property merely by virtue of their relationships. Their interests vest only at an inter vivos separation. If that separation never occurs during the spouses’ or partners’ lifetimes, the property interest never vests.

24. Failed Cy Pres Action. In Application of Bogaty to Further Modify a Bequest for Charitable Purposes Pursuant to EPTL § 8-1.1 Affecting Estate of Rühle, 2019 N.Y. Slip Op. 50214(U) (N.Y. Sur. 2019), the problem was that funds were set aside for male students of German ancestry at Brooklyn Technical High School but the executor holding the funds couldn’t find enough recipients. The opinion states:

For a second time, the court is presented with a petition requesting that it apply its cy pres powers to modify a testamentary charitable bequest set forth in decedent's last will and testament which was executed on March 30, 1999 and admitted to probate in 2008.

Article Fifth of the will directed the executor to establish a not-for-profit corporation as the vehicle to administer funds for a memorial scholarship to be awarded to a male student, of specific German ancestry, enrolled in certain engineering courses of study as offered by Brooklyn Technical High School (hereinafter “BTHS”). The funds distributed by the executor were to be used to defray the costs of “college tuition, room and board and related expenses.” The will further directed that a portion of the funds were also to be utilized to erect a memorial plaque bearing decedent's name and a verse on a wall at BTHS.
In February, 2011, the executor applied for *cy pres* relief from the court, averring that the administration of the scholarship fund through the formation of a not-for-profit corporation, as opposed to a trust, would incur unnecessary costs and that, more importantly, the stringent demographic and academic requirements set forth in the will could not be met.

The court, by decision dated July 7, 2011, found that decedent had expressed a generalized charitable intent and reformed the will to permit the fund to be administered by a trust, and broadened the pool of candidates eligible for assistance to male graduates of German ancestry on either the maternal or paternal side, and adjusted the academic requirements to ensure more clarity.

Despite the foregoing, the court is again faced with a request to further modify the testamentary charitable bequest.

Petitioner alleges that further application of the court's *cy pres* powers is necessary due to the continued inability to identify qualified male applicants graduating from BTHS who are of German ancestry. Consequently, no awards from the scholarship have been made.

So the executor’s next proposal was to transfer the funds to an Alumni Foundation that benefits BTHS. The court rejected the notion:

It is also noted that the modification proposed by petitioner totally eliminates the requirement, as previously modified by the Court, that the recipient be a male student of German ancestry. Petitioner alleges, and is supported in this regard by two affidavits submitted by the Acting Principal and the Chief Educational Officer of BTHS, that given the demographic composition of the high school, a graduate satisfying such criteria is, and will continue to be, “impossible” to find. As a result, they posit a general scholarship benefitting any enrolled student engaged in approved courses with appropriate grades would satisfy the decedent's intent. Again, the Court finds this argument totally unpersuasive.

The decedent unequivocally did not wish to confer a benefit on BTHS as an institution, but on a graduate thereof who fit specific criteria. Apparently decedent was seeking to reward a student most nearly resembling himself. While clearly graduation from BTHS was an important consideration in this regard, the Court cannot find it is a factor so overwhelming that its current inability to be satisfied should render moot all the other requirements set forth. To accept petitioner's position is to find that decedent really intended to benefit a group of candidates who fit none of the scholarship criteria (a male graduate of BTHS of Germanic ancestry with a certain academic average, attending college in pursuit of an engineering degree) as opposed to candidates who satisfy all the criteria, except possibly attendance at BTHS. The Court is absolutely unconvinced by petitioner's argument in this regard, especially considering the specificity in which decedent set forth all of his other testamentary dispositions.

25. **Interesting Remedy Applied By Oregon Court to Nevada Trust.** In Matter of Testamentary Trust Created Under Will of King, 295 Or.App. 176 (2018), the Oregon Court applied the trust’s choice of law clause in favor of Nevada. That was in question because the Trustee had powers as set forth under Minnesota law:

The parties dispute, however, whether those provisions of Nevada law are applicable. At trial, Sandra contended that, because she resides in Oregon and
many of the trust assets were located in Oregon, the court should apply Oregon law to evaluate the loans that she made to herself, Cameron, and the winery, while the children contended that the court should apply Nevada law. Two attorneys, including Schroeder, the attorney who drafted the will, testified about the effect of section 6.10. As relevant here, Schroeder testified that section “6.10 was inserted in the Will because the decedent was a resident of Nevada.” Schroeder testified that he and his co-drafter had intended that Minnesota law—in the form of the list of powers of the trustee that was incorporated into the will—would apply to the powers granted to the trustee, but otherwise Nevada law was to apply. As the trial court summarized, “[u]ltimately, [Schroeder] conceded that not much thought had been given to the interplay between [sections] 6.2 and 6.10, but he didn’t think it really mattered because the same fiduciary standards applied.”

The trial court concluded that “it is inescapable that, by the title and content of [section] 6.10, Nevada law was intended to apply to matters (i.e. questions) involving the administration of the trust.” Because NRS 163.030 prohibits insider loans by the trustee, the court concluded that all of the loans at issue were statutory breaches of trust despite the broad powers that section 6.2 purported to grant to the trustee.

In her first assignment of error, Sandra contends that the court erred in concluding that Nevada law applies to the determination whether the disputed loans were breaches of trust. To evaluate that argument, we consider the text of Article Six of the will, beginning with whether it is ambiguous. “When a trust instrument is fully integrated and is not ambiguous on its face, extrinsic evidence is not admissible to establish the grantor’s intent.” Samuel v. King, 186 Or.App. 684, 692, 64 P.3d 1206, rev. den., 335 Or. 443, 70 P.3d 893 (2003).

Whether a term in an agreement is ambiguous is a question of law. Yogman v. Parrott, 325 Or. 358, 361, 937 P.2d 1019 (1997). “An ambiguity is presented only when the language of the agreement is reasonably capable of more than one plausible interpretation.” Samuel, 186 Or.App. at 692, 64 P.3d 1206.

Section 6.10 of the will provides: “Nevada law to govern: The laws of the State of Nevada shall govern all questions which may arise with respect to the interpretation of this Will or the administration of any trust established hereunder.” (Underscoring in original.) In Sandra’s view, that text invokes Nevada law only as “a ‘gap filler,’ that is, to answer questions which the will does not.” She further contends that the loans do not raise any question “with respect to * * * the administration” of the DFK trust because the terms of the trust “specifically authorized her to loan money to whomsoever she chose, including herself, family members or companies with which she had a relationship.” Sandra cites the powers listed in the incorporated section of Minnesota law as further support for her position that the trust authorized the loans, but she does not advance any developed argument that Oregon or Minnesota law governs the operation of the trust.

Sandra’s argument that the choice-of-law provision operates only as a “gap filler” is untenable. It overlooks the fact that, although a settlor has considerable latitude to dictate how a trust will operate, the trust nevertheless operates within and has effect only to the extent that it complies with the trust law of some jurisdiction. See, e.g., ORS 130.030 (“The meaning and effect of the terms of a trust are determined by: (1) The law of the state, country or other jurisdiction designated in the terms of the trust * * *; or (2) In the absence of a controlling designation in the terms of the trust, the law of the state, country or other jurisdiction having the most significant relationship to the matter at issue.”).
Each jurisdiction has default rules of construction and validity of trusts, and each has some limitations on the settlor’s ability to dictate the terms of the trust. See, e.g., ORS 130.020 (listing exceptions to general principle that the terms of the trust prevail); NRS 163.160 (similar). The terms of the trust have legal effect only to the extent that they comply with the rules of the chosen jurisdiction. See generally ORS 130.030 (providing rules to determine which jurisdiction’s law controls “[t]he meaning and effect of the terms of a trust”).

In short, Sandra’s argument that the trust has independent legal meaning separate and apart from the law of any jurisdiction, and that Nevada law operates only interstitially, misconceives the law. The trust’s text, alone, cannot answer any questions except against the backdrop of the law of some jurisdiction. The trust must be governed by the law of a jurisdiction, and the DFK trust chooses Nevada. Thus, absent any further argument by Sandra, we conclude that, when section 6.10 says that Nevada law applies to “all questions which may arise with respect to * * * the administration of” the DFK trust, it means, unambiguously, that Nevada law governs the administration of the trust. See ORS 130.030(1) (giving effect to settlor’s choice of law as expressed in the trust). As explained above, Nevada law prohibits insider loans by the trustee regardless of whether such loans are allowed by the terms of the trust. NRS 163.030 (2009) (no “noncorporate trustee [shall] lend funds to himself or to his relative, employer, employee, partner or other business associate”); NRS 163.160 (“[N]o act of the settlor relieves a trustee from the duties, restrictions and liabilities imposed upon the trustee by NRS 163.030[.]”).

So, Sandra’s loans as trustee were improper. May the court direct that her income interest in the trust be redirected to the aggrieved beneficiaries, even though the trust is a spendthrift trust? The court concluded that remedies for a trust beneficiary are different than remedies for an outside third party. The opinion states:

Under Nevada law, a violation of NRS 163.010 to 163.200 by a trustee may be treated as a breach of trust. NRS 163.190 (“If a trustee violates any of the provisions of NRS 163.010 to 163.200, inclusive, * * * any beneficiary, cotrustee or successor trustee may treat the violation as a breach of trust.”). With respect to testamentary trusts, the probate court may compel “redress of a breach of trust,” NRS 153.031(I)(m), using its “full equitable powers,” Diotallevi v. Sierra Dev. Co., 95 Nev. 164, 591 P.2d 270, 272 (1979) (probate court’s “full equitable powers” include the power to apply a “practical and fair method” for protecting the interests of the trust beneficiaries).

Those equitable powers historically included the power to apply a breaching trustee-beneficiary’s interest in the trust to compensate the trust and other beneficiaries for losses caused by the breach of trust. Restatement of Trusts § 257 (1935) (“If a trustee who is also one of the beneficiaries commits a breach of trust, the other beneficiaries are entitled to a charge upon his beneficial interest to secure their claims against him for the breach of trust.”); accord. George Gleason Bogert, Trusts and Trustees, § 191 n. 47, 206-07 (1951); Restatement (Second) of Trusts, § 257 (1959); Restatement (Third) of Trusts, § 104 (2003). That principle applied with equal force to spendthrift trusts:

“Spendthrift Trust. The rule stated in this Section is applicable although the interest of the trustee-beneficiary is not transferable by him or subject to the claims of his creditors. Although his ordinary creditors cannot reach his interest under the trust and apply it to the satisfaction of their claims, his interest can be
impounded for the benefit of the other beneficiaries of the trust to make good any liability which he incurs for breach of trust.”

Restatement of Trusts, § 257 comment f (citation omitted); see also Restatement (Second) of Trusts, § 257 comment f (similar); Restatement (Third) of Trusts, § 104 comment h (“This rule applies even though the beneficiary’s interest is subject to a spendthrift restraint.” (Citation omitted.))

The Nevada Supreme Court recently indicated its adherence to the Restatement approach when it stated that “surcharging [the breaching trustee-beneficiary’s] interest” in the trust is an appropriate remedy for a breach of trust by a trustee-beneficiary. Montoya v. Ahearn, 426 P.3d 599, 603 (Nev. 2018). Thus, if the DFK trust were not a spendthrift trust, there is little question that the trial court could order that Sandra’s income interest be applied as a remedy to compensate for her breaches. The remaining question is whether a different result is required because the DFK is a spendthrift trust subject to NRS 166.120. We conclude that it is not.

The text of the statute provides that “payments,” “the income,” and “the interest of the beneficiary” may not be directed away from the beneficiary by voluntary or involuntary acts, including court orders; rather “the whole of the trust estate and the income of the trust estate shall go to and be applied by the trustee solely for the benefit of the beneficiary, free, clear, and discharged of and from any and all obligations of the beneficiary whatsoever and of all responsibility therefor.” NRS 166.120(2), (3). Although that text is worded broadly, it is written in terms of creditors and proceedings that are external to the affairs of the trust. Because breach-of-trust proceedings differ from all other types of proceedings in that they are internal to the trust and logically precede a trustee’s determination of the beneficiaries’ interests for distribution purposes, it is not clear that NRS 166.120 is intended to apply to them. For additional guidance, we “turn to other legitimate tools of statutory interpretation, including related statutes, relevant legislative history, and prior judicial interpretations of related or comparable statutes by [the Nevada Supreme Court] or other courts,” Andrews, 412 P.3d at 40, as well as the common law, including the Restatement (Second) of Trusts, see Brock, 390 P.3d at 650.

As explained above, all three restatements of the law of trusts recognize that a spendthrift provision does not prevent application of the rule that a breaching trustee-beneficiary’s interest can be applied to compensate other beneficiaries for losses incurred because of the breach of trust. Restatement of Trusts § 257 comment f; Restatement (Second) of Trusts § 257 comment f; Restatement (Third) of Trusts § 104 comment u. Moreover, since at least 1941, Nevada’s law of testamentary trusts has incorporated the common law of trusts. See NRS 163.190; Diotallevi, 591 P.2d at 271. Given those circumstances, we conclude that the Nevada Legislature did not intend NRS 166.120 to prohibit a surcharge of the breaching trustee-beneficiary’s interest as a remedy for that trustee-beneficiary’s own breach of trust, and that the Nevada Supreme Court would not apply the provision that way. Rather, if the legislature had intended NRS 166.120 to abrogate the well-established common law rule of surcharge of the breaching trustee-beneficiary’s interest, it would have said so explicitly.

The court noted that just down the road, a California court had relatively recently reached the same results:

A California appellate court addressed the same question in a case where the trust itself, rather than a statute, contained text similar to the text of NRS
Chatard v. Oveross, 179 Cal.App.4th 1098, 1100-01, 101 Cal.Rptr.3d 883, 886 (2009), rev. den., Feb. 10, 2010 (interpreting a trust instrument providing that “[t]he interest of any beneficiary in the principal or income of any trust created by this instrument shall not be subject to claims of his or her creditors, or others, or liable to attachment, execution or other process of law”). The court concluded that surcharge of the breaching trustee-beneficiary’s interest was not prohibited, and explained as follows:

“Reasonably construed, the language of the spendthrift provision here suggests protection against the claims of persons foreign to the trust—’creditors, or others’—who might use a writ of ‘attachment, execution or other process of law’ to satisfy a claim from a beneficiary’s interest. The language does not reasonably refer to the claims of fellow beneficiaries relating to a breach of trust, which might be satisfied, in the exercise of the probate court’s equitable power, by surcharging the interest of the trustee-beneficiary in the distribution of trust assets. In short, absent clear language to the contrary, we decline to read the spendthrift clause so as to permit the perverse result of depriving the court of its equitable power to surcharge the interest of dishonest trustee-beneficiary to compensate other beneficiaries for breaches of the trust.”

Chatard, 179 Cal.App.4th at 1107, 101 Cal.Rptr.3d at 890.

26. **Words Matter.** All the law in the world won’t help if the trust doesn’t say something that can be easily understood. If you want the trust to speak for itself, then make sure the trust doesn’t mumble.

Suppose co-trustees are directed to pay “any obligations the Donor’s spouse may incur in acquiring assisted living or nursing home care … .” What are the trustees obligated to pay: only the original costs of obtaining and moving into assisted living, or the regular, on-going monthly costs of assisted living?

The Supreme Court of North Dakota determined this language was ambiguous and directed the lower court to “make findings on the evidence” of the settlor’s intent in using this language in In the Trust of Roger S. Linn Restated Trust Agreement, 923 N.W.2d 815(N.D. 2019). The Donor’s spouse was already receiving regular monthly income distributions from the trust, so the question was whether extra amounts should be distributed.

27. **Words Matter II.** In Famiglio v. Famiglio, 2019 WL 2063578 (Fl. App. 2d Dist. 2019), the prenuptial agreement distinguished between amounts of money due from husband to wife based on whether a petition for dissolution had been filed at certain times. The Court explains what happened:

As it happened, two different petitions were filed in two different years.

On March 25, 2013, the Wife filed a petition for dissolution of marriage in the Sarasota County Circuit Court. At that time, the parties would have been married for seven full years under the Prenuptial Agreement. That petition was never served, however, and on September 13, 2013, the Wife voluntarily dismissed the petition without prejudice.

On May 26, 2016, the Wife filed a second petition for dissolution of marriage in the Sarasota County Circuit Court. By this time, the parties had been married ten
full years for purposes of section 5.3 of the Prenuptial Agreement. The litigation pertaining to this second petition remains pending.

The Husband then filed the underlying action for declaratory relief, seeking the court's construction of various provisions in the parties' Prenuptial Agreement.2 Relevant to this appeal, the Husband maintained that the Wife's filing of the first petition in 2013 became the operative year of measurement for purposes of section 5.3, so that she would be entitled to a payment of $2.7 million. The Wife argued that her second petition, the one that would result in an actual dissolution of the parties' marriage, controlled the operation of section 5.3. According to the Wife, she should receive $4.2 million under this provision of the Prenuptial Agreement.

The trial court found for the Wife on the issue of when a petition was filed. The Court of Appeals reversed. The opinion states:

We can only rely on the natural meaning of the phrase: "at the time a Petition for Dissolution of Marriage is filed." See In re Guardianship of Sapp, 868 So. 2d 687, 691 (Fla. 2d DCA 2004) ("Words and phrases should be given their natural meaning or a meaning most commonly understood in relation to the subject matter and circumstances."); J.N. Laliotis Eng'g Constr., Inc. v. Mastor, 558 So. 2d 67, 68 (Fla. 2d DCA 1990) ("Words used in an agreement should be given 'a natural meaning or the meaning most commonly understood in relation to the subject matter and circumstances.' ") (quoting Granados Quinones v. Swiss Bank Corp., 509 So. 2d 273, 275 (Fla. 1987))). As we observed at the outset, it seems clear that the intent of this discrete provision is to link the lump sum alimony measurement to a singular occurrence—when a petition is filed with a court. Cf. The American Heritage Dictionary of the English Language 8057 (3d ed. 2000) ("when . . . conj. 1. At the time that"). In common parlance, predicating a condition on "when something occurs" or "at the time something occurs," is normally understood to mean the first time that the something occurs. This is so because conditional statements such as these are made with a view towards the future, as a way of indicating that a consequent condition will arise from a future condition's occurrence. And since the future cannot be known (except in hindsight), we would ordinarily read a provision like section 5.3.a. to align with the way we experience the passing of temporal events; that is, we would consider the future condition's first occurrence to be the operative one, even if it is a condition that might be capable of repetition. Thus, a golf course's rule, "when a thunderstorm approaches, you must end your golf game," would be universally understood to mean the first time a thunderstorm approaches. Certainly, more than one storm might come and go throughout the day, but the rule would make little sense if it were construed to mean whichever storm the golfer chooses, so long as the game is ended.

That is how section 5.3.a. must be understood. Its natural meaning and frame of reference is to tie, prospectively, a variable sum of alimony on the singular occurrence of the filing of "a petition" for dissolution of marriage, which, in its most usual sense, would mean the first time such a petition is filed. In this case, that occurred on March 25, 2013.

28. South Dakota Refuses To Enforce California Child Support Order. In Matter Cleopatra Cameron Gift Trust, Dated May 26, 1998, 931 N.W.2d 244 (SD. 2019), the South Dakota Supreme Court held that a
California order directing a trustee to pay child support for a beneficiary’s children was not entitled to full faith and credit in South Dakota because it was a method of enforcement only. The opinion states:

The Full Faith and Credit Clause of the United States Constitution provides that, “Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State.” U.S. Const. art. IV, § 1. The command to afford the judgments of foreign states full faith and credit is further codified at 28 U.S.C. § 1738 (2013), which provides that authenticated records and judicial proceedings “shall have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State[.]”

The United States Supreme Court has recognized that providing full faith and credit to the judgments of foreign states serves the salutary purpose of limiting the opportunity to relitigate issues that have been resolved previously through the judicial process. Riley v. New York Trust Co., 315 U.S. 343, 348-49, 62 S. Ct. 608, 612, 86 L. Ed. 885 (1942). As a result, the Full Faith and Credit Clause “alter[s] the status of the several states as independent foreign sovereigns, each free to ignore obligations created under the laws or by the judicial proceedings of the others, and ... make[s] them integral parts of a single nation.” V.L. v. E.L., — U.S. ——, 136 S. Ct. 1017, 1020, 194 L. Ed. 2d 92 (2016) (per curiam) (quoting Milwaukee County v. M.E. White Co., 296 U.S. 268, 277, 56 S. Ct. 229, 234, 80 L. Ed. 220 (1935)); see also Wooster v. Wooster, 399 N.W.2d 330, 334 (S.D. 1987) (recognizing that valid foreign judgments are given effect in the interests of comity).

Generally, if the judgment was “rendered by a court with adjudicatory authority over the subject matter and persons governed by the judgment, [it] qualifies for recognition throughout the land.” Id. Furthermore, “[a] State may not disregard the judgment of a sister State because it disagrees with the reasoning underlying the judgment or deems it to be wrong on the merits.” Id.; see also Milliken v. Meyer, 311 U.S. 457, 462, 61 S. Ct. 339, 342, 85 L. Ed. 278 (1940) (“[T]he full faith and credit clause of the Constitution precludes any inquiry into the merits of the cause of action, the logic or consistency of the decision, or the validity of the legal principles on which the judgment is based.”).

There are, however, certain limitations upon the requirements of the Full Faith and Credit Clause. Providing full faith and credit to a foreign state’s judgment “does not mean that States must adopt the practices of other States regarding the time, manner, and mechanisms for enforcing judgments. Enforcement measures do not travel with the sister state judgment as preclusive effects do; such measures remain subject to the evenhanded control of forum law.” Baker by Thomas v. Gen. Motors Corp., 522 U.S. 222, 235, 118 S. Ct. 657, 665, 139 L. Ed. 2d 580 (1998); see also Restatement (Second) of Conflict of Laws § 99 (1971) (“The local law of the forum determines the methods by which a judgment of another state is enforced.”). “‘Evenhanded’ means only that the state executes a sister state judgment in the same way that it would execute judgments in the forum court.” Adar v. Smith, 639 F.3d 146, 159 (5th Cir. 2011).

Justice Scalia, in his concurring opinion in Baker, noted that the power of the Full Faith and Credit Clause is to make the judgment of “one State[ ] conclusive evidence in the courts of another State[.]” 522 U.S. at 242, 118 S. Ct. at 668 (Scalia, J. concurring) (quoting Wisconsin v. Pelican Ins. Co., 127 U.S. 265, 291-92, 8 S. Ct. 1370, 1375, 32 L. Ed. 239 (1888)). Yet despite the preclusive power of one state’s judgment, it “can only be executed in [the forum state] as
its laws may permit.” Id. (quoting Lynde v. Lynde, 181 U.S. 183, 187, 21 S. Ct. 555, 556, 45 L. Ed. 810 (1901)); see also Adar, 639 F.3d at 161 (holding there was no violation of the Full Faith and Credit Clause where a Louisiana registrar recognized the validity of a New York adoption decree, but only allowed one unmarried parent’s name on the Louisiana birth certificate because under Louisiana law, only married couples could jointly adopt).

Here, an examination of the statute upon which the family court relied to order direct Trust payments to Christopher reveals it to be a conspicuous method of enforcing a support obligation where an obligor is the beneficiary of a trust protected by a spendthrift provision:

(c) Whether or not the beneficiary has the right under the trust to compel the trustee to pay income or principal or both to or for the benefit of the beneficiary, the court may, to the extent that the court determines it is equitable and reasonable under the circumstances of the particular case, order the trustee to satisfy all or part of the support judgment out of all or part of future payments that the trustee, pursuant to the exercise of the trustee’s discretion, determines to make to or for the benefit of the beneficiary.

(d) This section applies to a support judgment notwithstanding any provision in the trust instrument.

Cal. Prob. Code § 15305 (emphasis added.)

It is equally clear that the Ventura County court also perceived Cal. Prob. Code § 15305 to be an enforcement provision. The Ventura County court broadened the enforcement authority of California trial courts to order direct trust payments, notwithstanding a spendthrift provision, upon a finding the trustee acted in bad faith by not authorizing a distribution. The court described Cal. Prob. Code § 15305 as a means of enforcing the support order, observing, “A spendthrift provision ‘is not effective to exempt the trust from enforcement of a judgment for support of a minor child ....’” Ventura Cty., 11 Cal. Rptr. 3d at 495 (emphasis added) (quoting Cal. Prob. Code § 15305, cmt.).

Viewed in this context, the family court’s order compelling the direct payment of child support from the Trust was an unmistakable means of enforcing Cleopatra’s obligation. Christopher’s counsel acknowledged at oral argument that the direct payment order was, in truth, an enforcement method. In our view, the trustee was not the child support obligor and was only nominally joined in the divorce action to enforce Cleopatra’s obligation. Because the means of enforcing judgments does not implicate full faith and credit considerations, the circuit court here was not required to submit to the California order compelling direct payments from the Trust if this method of self-executing enforcement is not authorized by South Dakota law. Based upon a review of our relevant statutes, it is not authorized and is, in fact, expressly prohibited.

Our Legislature has placed formidable barriers between creditor claims and trust funds protected by a spendthrift provision. See SDCL 55-1-41 (“If the trust contains a spendthrift provision, no creditor may reach present or future mandatory distributions from the trust at the trust level.”); SDCL 55-1-35 (“No trustee is liable to any creditor for paying the expenses of a spendthrift trust.”). More to the point, the Legislature has emphatically rejected even the specter of an argument that would allow a child support creditor to reach trust funds protected by a spendthrift provision. Indeed, this precise legal theory is identified in § 59 of the Restatement (Third) Trusts (2003) which states that
“[t]he interest of a beneficiary in a valid spendthrift trust can be reached in satisfaction of an enforceable claim against the beneficiary for ... support of a child ...” However, the Legislature anticipated such an argument in South Dakota courts and definitively foreclosed it with its 2007 enactment of SDCL 55-1-25 which provides in part:

In the area of creditor rights, the Restatement of Trusts (Third) and the Uniform Trust Code create many new positions of law as well as adopts many minority positions of law. The provisions of §§ 55-1-24 to 55-1-43, inclusive, affirmatively reject many of these positions. Therefore, the Legislature does not intend the courts to consult the Restatement (Third) of the Law of Trusts ... § 59 ... with respect to subject matters addressed by the provisions of §§ 55-1-24 to 55-1-43, inclusive.

(Emphasis added); see also Richardson v. Richardson, 2017 S.D. 92, ¶ 16, 906 N.W.2d 369, 374 (stating that courts “must be mindful of the Legislature’s public policy determinations ....”).

The trust had been subject to various courts in California during the divorce of a beneficiary, Cleopatra. Cleopatra was at that time a co-trustee with a corporate fiduciary. Ultimately Cleopatra changed situs to South Dakota, with positive results (assuming she didn’t want to pay continuing child support).

29. **South Carolina Supreme Court Abolishes Common Law Marriage.** The South Carolina Supreme Court abolished common law marriage in Stone v. Thompson, 2019 WL 3310480 (SC 2019), but did so only prospectively. It’s reasoning is instructive and follows a national trend. The opinion states:

Common-law marriage in South Carolina rests upon moral paternalism, as our courts have long recognized. Id. at 166-67, 177 S.E.2d at 539 (“The law presumes morality, and not immorality; marriage, and not concubinage; legitimacy, and not bastardy.” (quotation omitted)). While our legislature has not expressly codified common-law marriage, it has recognized the institution by exception to the general requirement to obtain a marriage license. S.C. Code Ann. § 20-1-360 (2014).

b. **The Modern Trend**

The prevailing trend, however, has been repudiation of the doctrine. The reasons have been myriad—from economic to social—including some more nefarious than others. Bowman, supra, at 731-49. Alabama became the most recent state to do so, enacting Ala. Code 1975 § 30-1-20 in 2016. See Blalock v. Sutphin, — So. 3d —, —, 2018 WL 5306884 at *5 (Ala. 2018). By our count, this leaves fewer than ten jurisdictions that currently recognize the institution. 2

In 2003, the Pennsylvania Commonwealth Court set forth a thorough explanation for its conclusion that common-law marriage should no longer be recognized in PNC Bank Corp. v. W.C.A.B. (Stamos), 831 A.2d 1269 (Pa. Commw. Ct. 2003). 3 Notably, the court determined:

The circumstances creating a need for the doctrine are not present in today's society. A woman without dependent children is no longer thought to pose a danger of burdening the state with her support and maintenance simply because she is single, and the right of a single
parent to obtain child support is no longer dependent upon his or her marital status. Similarly, the marital status of parents no longer determines the inheritance rights of their children. Access to both civil and religious authorities for a ceremonial marriage is readily available in even the most rural areas of the Commonwealth. The cost is minimal, and the process simple and relatively expedient.

831 A.2d at 1279 (internal citations omitted). The court also pointed to benefits of standardized formal marriage requirements such as predictability, judicial economy, and upholding the statutes’ “salutary” purposes. Id. at 1279-81.

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We find the Pennsylvania court's reasoning and other considerations sufficiently persuasive to adopt a bright-line rule requiring those who wish to be married in South Carolina to obtain a lawful license. Our law contains similar provisions regarding child support, inheritance, and the ceremonial marriage process. See S.C. Code Ann. §§ 20-1-210 to -240 (1976); §§ 62-2-101 to -109 (1976 & Supp. 2018); § 63-5-20 (1976 & Supp. 2018). The paternalistic motivations underlying common-law marriage no longer outweigh the offenses to public policy the doctrine engenders. By and large, society no longer conditions acceptance upon marital status or legitimacy of children. The current case is emblematic of this shift, as the parties' community of friends was wholly unconcerned with their marital status, and indeed several of their witnesses were in similar relationships. Meanwhile, courts struggle mightily to determine if and when parties expressed the requisite intent to be married, which is entirely understandable given its subjective and circumstantial nature. The solemn institution of marriage is thereby reduced to a guessing game with significant ramifications for the individuals involved, as well as any third party dealing with them.

Critically, non-marital cohabitation is exceedingly common and continues to increase among Americans of all age groups. The right to marry is a fundamental constitutional right, Obergefell v. Hodges, — U.S. ——, 135 S. Ct. 2584, 2604-05, 192 L.Ed.2d 609 (2015), which leads us to believe the right to remain unmarried is equally weighty, particularly when combined with our admonitions that a person cannot enter into such a union accidentally or unwittingly, Callen v. Callen, 365 S.C. 618, 626, 620 S.E.2d 59, 63 (2005). Further, we must agree with the many observers who have noted that common-law marriage requirements are a mystery to most. The present case is again illustrative. None of the multiple witnesses who were asked understood what was required to constitute a common-law marriage, despite the fact that, as mentioned, several were involved in lengthy cohabitating relationships themselves. Moreover, two of such partners testified in complete opposition to one another, with one reporting they were common-law married, and the other stating emphatically they were not. This further persuades us to reject a mechanism which imposes marital bonds upon an ever-growing number of people who do not even understand its triggers.

Our public policy is to promote predictable, just outcomes for all parties involved in these disputes, as well as to emphasize the sanctity of marital union. We can discern no more efficacious way to fulfill these interests than to require those who wish to be married in our State to comply with our statutory requirements. Our quest to see inside the minds of litigants asserting different motivations and levels of knowledge at varying times must yield to the most reliable measurement of marital intent: a valid marriage certificate.
Interestingly, the court noted that the South Carolina Legislature had tried eight times since 1998 to eliminate common law marriage. As the court notes, cohabitation is increasingly common. The Uniform Law Commission is drafting an act addressing the Economic Rights of Unmarried Cohabitants.