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**Advanced Estate Planning Practice Update:
Summer 2020**

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Summer 2020**

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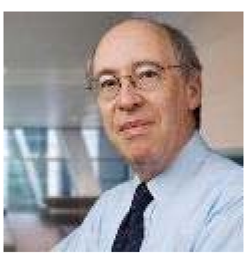
Professor Pennell is the Richard H. Clark Professor of Law at Emory University School of Law in Atlanta, where he teaches income tax, wealth transfer tax, trusts and estates, estate planning, and legal ethics. A member of the American Law Institute, he was an Adviser for the Restatements (Third) of Property (Wills and Other Donative Transfers), and the Restatement (Third) of Trusts, a former member of the Council of the Real Property, Trust & Estate Section of the American Bar Association, an Academic Fellow and Former Regent of the American College of Trust and Estate Counsel, and an Academician of The International Academy of Estate and Trust Law.

Earlier in his career Professor Pennell practiced as an attorney with the The Northern Trust Company in Chicago. He has also taught as an Assistant Professor of Law at the University of Oklahoma; Visiting Assistant Professor of Law, Southern Methodist University; Professor of Law, University of Oklahoma; and Visiting Adjunct Professor of Law, University of Miami. He speaks widely and has published extensively, primarily regarding donative transfers, estate planning, ethics, and tax. His various publications include student and practitioner texts, Tax Management portfolios, articles, institute chapters, and he is the successor author of Casner & Pennell on ESTATE PLANNING (8th ed.).

He earned both his B.S. and J.D. from Northwestern University.

FACULTY



Lawrence P. Katzenstein, St. Louis, Missouri
Thompson Coburn LLP

Larry practices in the firm's private client services area with a concentration on estate planning and charitable giving, and representation of exempt organizations. He is a nationally known authority on estate planning and planned giving, and a frequent speaker around the country to professional groups. He has been retained by the Internal Revenue Service to provide continuing legal education programs to Internal Revenue Service estate and gift tax attorneys.

He appears annually on several American Law Institute CLE estate planning programs and has spoken at many other national tax institutes, including the Notre Dame Tax Institute, the University of Miami Heckerling Estate Planning Institute and the Southern Federal Tax Institute. Larry is an adjunct professor at the Washington University School of Law where he has taught both estate and gift taxation and fiduciary income taxation.

A former chair of the American Bar Association Tax Section Fiduciary Income Tax Committee, he is current chair of several Tax Section charitable planning subcommittees. He is a fellow of the American College of Trust and Estate Counsel and a member of its Charitable Planning Committee and a member of the advisory board of the New York University National Center on Philanthropy and the Law. He is listed in *The Best Lawyers in America®* in the field of Trusts and Estates. Larry was named the St. Louis Non-Profit/Charities Lawyer of the Year in 2011 and 2015 and the St. Louis Trusts and Estates Lawyer of the Year in 2010 and 2013 by *Best Lawyers®*. He was nationally ranked in the 2009-2017 editions of *Chambers USA* for Wealth Management. Larry is also the creator of Tiger Tables actuarial software, which is widely used by tax lawyers and accountants as well as the Internal Revenue Service.

Stephanie Loomis-Price, Houston, Texas
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Stephanie Loomis-Price is a Shareholder and Co-Chair of Fiduciary Litigation at Winstead.

She handles federal gift and estate tax litigation against the Internal Revenue Service across the nation, as well as state fiduciary and probate controversy work. She has assisted clients in numerous cases in the United States Tax Court, the United States Court of Federal Claims, and the United States Court of Appeals for the Fifth, Eighth, and Eleventh Circuits, as well as County Probate Courts in Texas. She also counsels clients regarding complex estate administration and minimizing litigation and audit risks. Stephanie currently serves as TE Division Vice Chair for the Real Property, Trust & Estate Law Section of the American Bar Association.

Board Certified in Estate Planning and Probate Law, Stephanie is a Fellow of and Regent for the American College of Trust and Estate Counsel. She has authored a BNA portfolio and is in the process of finalizing another.

Prior to entering private practice, Stephanie served as a law clerk to the Honorable Lawrence S. Margolis of the United States Court of Federal Claims in Washington, D.C.

Kathleen R. Sherby, St. Louis, Missouri
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Kathleen Sherby is a partner in the Private Client Group and co-leader of the Fiduciary Litigation Team.

Ms. Sherby's practice involves representation of private individuals in all aspects of wealth transfer planning, including the implementation of sophisticated planning techniques involving grantor retained annuity trusts, family limited partnerships/limited liability companies, charitable remainder trusts, charitable lead trusts and other similar wealth transfer techniques.

Ms. Sherby has represented both trustees and beneficiaries on a wide variety of fiduciary issues and has advised trustees over the years as to their fiduciary duties in administering trusts. In addition, Ms. Sherby has represented the taxpayer in estate and gift tax audits, in U.S. District Court, the U.S. Tax Court, and in the Missouri Supreme Court. A particular focus of her practice is estate planning for retirement benefits, integrating the planning for minimization of transfer tax and income tax with the required minimum distribution rules.

Ms. Sherby has represented many business owners in developing an effective business succession plan, which has included strategies to transition the business to the next generation as well as working through the sale of the business where appropriate. She has also advised trustees on handling and selling a business and real estate as unique trust assets.

Ms. Sherby is a well-known national lecturer on all of these topics at significant national conferences.

An active participant in the estate planning bar, Ms. Sherby is a Fellow of the American College of Trust and Estate Counsel, and is a Past President and a Regent Emeritus of the College and has served as chair of the Employee Benefits in Estate Planning Committee and as Missouri State Chair. She has also served as chair of the Probate and Trust Committee of the Missouri Bar, as chair of the Probate Section of the Bar Association of Metropolitan St. Louis and as president of the Estate Planning Council of St. Louis.

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ESTATE PLANNING IN A LOW INTEREST RATE ENVIRONMENT

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Introduction

The unprecedentedly low interest rate environment in which we now practice, especially when accompanied by depressed asset values, has created a rare opportunity for estate planners to take advantage of those interest-sensitive techniques that work particularly well when interest rates are low. This paper looks at how interest rates affect various techniques, with particular emphasis on GRATs and charitable lead trusts, both of which work particularly well when interest rates are low.

The following table shows just how low current interest rates are, compared to historic rates since the adoption of §7520 in 1989.

§7520 Rates Since May 1, 1989

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
2020	2.0	2.2	1.8	1.2	0.8	0.6						
2019	3.4	3.2	3.2	3.0	2.8	2.8	2.6	2.2	2.2	1.8	2.0	2.0
2018	2.6	2.8	3.0	3.2	3.2	3.4	3.4	3.4	3.4	3.4	3.6	3.6
2017	2.4	2.6	2.4	2.6	2.4	2.4	2.2	2.4	2.4	2.2	2.4	2.6
2016	2.2	2.2	1.8	1.8	1.8	1.8	1.8	1.4	1.4	1.6	1.6	1.8
2015	2.2	2.0	1.8	2.0	1.8	2.0	2.2	2.2	2.2	2.0	2.0	2.0
2014	2.2	2.4	2.2	2.2	2.4	2.2	2.2	2.2	2.2	2.2	2.2	2.0
2013	1.0	1.2	1.4	1.4	1.2	1.2	1.4	2.0	2.0	2.4	2.0	2.0
2012	1.4	1.4	1.4	1.4	1.6	1.2	1.2	1.0	1.0	1.2	1.0	1.2
2011	2.4	2.8	3.0	3.0	3.0	2.8	2.4	2.2	2.0	1.4	1.4	1.6
2010	3.0	3.4	3.2	3.2	3.4	3.2	2.8	2.6	2.4	2.0	2.0	1.8
2009	2.4	2.0	2.4	2.6	2.4	2.8	3.4	3.4	3.4	3.2	3.2	3.2
2008	4.4	4.2	3.6	3.4	3.2	3.8	4.2	4.2	4.2	3.8	3.6	3.4
2007	5.6	5.6	5.8	5.6	5.6	5.6	6.0	6.2	5.8	5.2	5.2	5.0

2006	**5.4**	**5.2**	**5.4**	**5.6**	**5.8**	**6.0**	**6.0**	**6.2**	**6.0**	**5.8**	**5.6**	**5.8**
2005	**4.6**	**4.6**	**4.6**	**5.0**	**5.2**	**4.8**	**4.6**	**4.8**	**5.0**	**5.0**	**5.0**	**5.4**
2004	**4.2**	**4.2**	**4.0**	**3.8**	**3.8**	**4.6**	**5.0**	**4.8**	**4.6**	**4.4**	**4.2**	**4.2**
2003	**4.2**	**.0**	**3.8**	**3.6**	**3.8**	**3.6**	**3.0**	**3.2**	**4.2**	**4.4**	**4.0**	**4.2**
2002	**5.4**	**5.6**	**5.4**	**5.6**	**6.0**	**5.8**	**5.6**	**5.2**	**4.6**	**4.2**	**3.6**	**4.0**
2001	**6.8**	**6.2**	**6.2**	**6.0**	**5.8**	**6.0**	**6.2**	**6.0**	**5.8**	**5.6**	**5.0**	**4.8**
2000	**7.4**	**8.0**	**8.2**	**8.0**	**7.8**	**8.0**	**8.0**	**7.6**	**7.6**	**7.4**	**7.2**	**7.0**
1999	**5.6**	**5.6**	**5.8**	**6.4**	**6.2**	**6.4**	**7.0**	**7.2**	**7.2**	**7.2**	**7.4**	**7.4**
1998	**7.2**	**6.8**	**6.8**	**6.8**	**6.8**	**7.0**	**6.8**	**6.8**	**6.6**	**6.2**	**5.4**	**5.4**
1997	**7.4**	**7.6**	**7.8**	**7.8**	**8.2**	**8.2**	**8.0**	**7.6**	**7.6**	**7.6**	**7.4**	**7.2**
1996	**6.8**	**6.8**	**6.6**	**7.0**	**7.6**	**8.0**	**8.2**	**8.2**	**8.0**	**8.0**	**8.0**	**7.6**
1995	**9.6**	**9.6**	**9.4**	**8.8**	**8.6**	**8.2**	**7.6**	**7.2**	**7.6**	**7.6**	**7.4**	**7.2**
1994	**6.4**	**6.4**	**6.4**	**7.0**	**7.8**	**8.4**	**8.2**	**8.4**	**8.4**	**8.6**	**9.0**	**9.4**
1993	**7.6**	**7.6**	**7.0**	**6.6**	**6.6**	**6.4**	**6.6**	**6.4**	**6.4**	**6.4**	**6.0**	**6.2**
1992	**8.2**	**7.6**	**8.0**	**8.4**	**8.6**	**8.4**	**8.2**	**7.8**	**7.2**	**7.0**	**6.8**	**7.4**
1991	**9.8**	**9.6**	**9.4**	**9.6**	**9.6**	**9.6**	**9.6**	**9.8**	**9.6**	**9.0**	**8.6**	**8.4**
1990	**9.6**	**9.8**	**10.2**	**10.6**	**10.6**	**11.0**	**10.6**	**10.4**	**10.2**	**10.6**	**10.6**	**10.2**
1989	**10***	**10***	**10***	**10***	**11.6**	**11.2**	**10.6**	**10.0**	**9.6**	**10.2**	**10.0**	**9.8**

* Section 7520 became effective May 1, 1989. For transactions occurring in the first four months of 1989, regulations required use of a 10% interest assumption.

As this table shows, the §7520 rate has been as high as 11.6% and was generally in the 7 to 9% range for the entire decade from 1990 to 2000. The extraordinary June, 2020 §7520 rate of 0.6% created what may be once-in-a-lifetime opportunities, especially when coupled with depressed asset values.

Math 101

First a little math 101. The present value of the remainder after a term of years — i.e., the value of the right to receive an amount in the future discounted by an interest rate to reflect the time value of money — can be determined by the following formula:

$$\left(\frac{1}{1+i}\right)^{t}$$

where i = the §7520 rate and t equals the number of years in the term.

For example, the value of the right to receive $1 in ten years, assuming a 3% interest rate is:

$$\left(\frac{1}{1.03}\right)^{10} = .744094$$

Because the value of the income interest and the value of the remainder interest must add up to 1, the value of the income interest must be 1 minus .744094 = .255906.

What is the value of an annuity of $1.00 for a term of ten years at a 3% interest rate? Simply

$$\frac{income\ interest}{interest\ rate}$$

Or

$$\frac{.255906}{.03} = 8.5302$$

<u>Key takeaways</u>: When interest rates are low, an income interest is worth less because I am assumed to be earning less. And if an income interest is worth less, the remainder after an income interest must be worth more — it is being discounted less. But, although the right to an income interest is worth less if interest rates are low, an annuity interest is worth *more* because the stream of payments is being discounted less. If I were entitled to an annuity of $100 a year for 10 years and the interest rate was zero, the annuity would be worth $1000. It becomes worth less as soon as we start discounting it.

<u>GRATS</u>

Because grantor retained annuity trusts ("GRATs") are particularly attractive when interest rates are low, we will start there, paying particular attention to the effect of interest rates on GRAT planning. In the days before Chapter 14, our clients created grantor retained *income* trusts in which fiduciary accounting income was returned rather than an annuity. But that gave donors an incentive to create GRITs with an assumed interest rate of 10%, which were then invested in growth assets, which meant the retained income interest was being overvalued. So Congress changed the rules so that the retained annuity interest in a trust would have some relationship to what was actually being retained and would have no relationship to how the trust assets were actually invested.

There are two ways to do this: either the grantor can be required to keep a retained annuity interest, or the grantor can be required to keep a retained fixed percent of the trust as revalued annually (a unitrust interest). It will be readily apparent that, if I retain the right to receive a fixed dollar amount annuity each year, I have no economic incentive to invest the trust one way or the other. Regardless of how the trust is invested, I will receive the same dollars each year and a proper valuation can be made of the right to receive the fixed dollar amount. The same is true with a unitrust interest. If I receive a fixed percent of the trust revalued annually, it becomes irrelevant whether the trust is being invested in high-income, low-appreciation assets, or in low-income, high-appreciation assets, because a unitrust interest is ownership of a piece of everything. Because interest rates are essentially irrelevant in valuing a unitrust interest, actual investment performance will not matter and my retained unitrust interest will be correctly valued.

So this is what was done in Chapter 14. Section 2702 provides that, for purposes of determining whether the transfer of an interest in trust to or for the benefit of a member of the transferor's family is a gift (and the value of the gift), the value of any interest retained by the transferor is valued at zero unless the retained interest is a qualified interest (i.e., unitrust or annuity), or the transfer consists of a transfer in trust of a personal residence. If the interest is not a qualified interest, for tax purposes it is valued at zero and nothing is deemed to have been kept for gift tax purposes. A reversion, for this reason, is not a qualified retained interest and will not be deemed part of the retained interest except in the case of a personal residence GRIT.

Economic Benefits of GRATs

Let us next look at the mathematics of creating GRATs structured so that there is no up–front gift, and look at how the GRAT would actually perform in practice. Let us fund a ten-year GRAT with one million dollars. We know that the value of an annuity of one dollar paid for a 10-year term (at a 3% §7520 rate) is $8.5302. How much of an annuity, therefore, do we have to pay to have the retained interest exactly equal the amount in the trust? Or, to put it another way, what number multiplied by 8.5302 will equal $1,000,000?

$$8.5302x = \$1{,}000{,}000$$

Therefore, x equals one million divided by 8.5302 or $117,230.

The following spreadsheet shows that the trust would be exhausted if the trust is invested at 3% and pays out an annuity of $117,230, with the payment of the final annuity in year ten.

Year	Opening Balance	Assumed Growth	Annuity	Ending Balance
1	$1,000,000	$30,000	$117,230	$912,770
2	$912,770	$27,383	$117,230	$822,923
3	$822,923	$24,688	$117,230	$730,381
4	$730,381	$21,911	$117,230	$635,062
5	$635,062	$19,052	$117,230	$536,884
6	$536,884	$16,107	$117,230	$435,761
7	$435,761	$13,073	$117,230	$331,603
8	$331,603	$9,948	$117,230	$224,322
9	$224,322	$6,730	$117,230	$113,821
10	$113,821	$3,415	$117,230	$6

If, however, the trust earns 5%, at the end of 10 years the trust will have $154,388 remaining, which will pass to the beneficiaries free of all transfer tax.

Year	Opening Balance	Assumed Growth	Annuity	Ending Balance
1	$1,000,000	$50,000	$117,230	$932,770
2	$932,770	$46,639	$117,230	$862,179
3	$862,179	$43,109	$117,230	$788,057
4	$788,057	$39,403	$117,230	$710,230
5	$710,230	$35,512	$117,230	$628,512
6	$628,512	$31,426	$117,230	$542,707
7	$542,707	$27,135	$117,230	$452,613
8	$452,613	$22,631	$117,230	$358,013
9	$358,013	$17,901	$117,230	$258,684
10	$258,684	$12,934	$117,230	$154,388

Note these key things:

- What we are removing from the grantor's estate is *growth in excess of the §7520 rate*. So, *when the §7520 rate is low, it is much easier to beat that benchmark.*
- A low interest rate enhances the value of an annuity, with an interest rate of 0.6% (the June 7520 rate) the annual annuity in a 10 year term trust necessary to reduce the remainder gift to family to zero is $103,329. If the 7520 interest rate were 5% (and it has been as high as 11.6%) the annuity necessary to reduce the remainder gift to family to zero would be $129,505.

Note also that, in a zero–out GRAT, all of the value of the underlying property is being added back to the estate, where it will continue to grow and eventually be subject to estate tax. (In most cases there will not be sufficient cash or other property to avoid payment of the annuity in kind. Because the trust is structured as a grantor trust, there is no gain when the annuity is satisfied with appreciated property.)

With a GRAT the original underlying property will still be subject to tax, whereas with an outright gift all of the future income and appreciation is removed from the grantor's estate. Or, to put it another way, with the GRAT we remove from the estate appreciation in excess of the §7520 rate. The transfer tax cost of establishing a zeroed–out GRAT is zero (if such a thing can be created). With an outright gift, *all* future appreciation is removed from the estate, with no transfer tax cost as to that appreciation. The underlying property will be subject to gift tax, but in the GRAT that is true as well because it will all be added to the estate through annuity payments, as seen in the above illustrations. What is attractive about the GRAT is that no gift tax is incurred up front and nothing has been lost if the assets *decline* in value. The GRAT is risk-free in a way that the outright gift is not. Our incredibly low June, 2020 §7520 rate of 0.6% coupled with depressed asset values make GRATs even more beneficial than usual.

The following chart shows how much is left at the end of a ten-year term, assuming various trust growth rates, if I establish a zeroed-out GRAT with $10,000,000 when the §7520 rate is 0.6%:

Total return	Amount Left at Trust Termination in 10 Years
3%	$1,593,629
4%	$2,396,628

5%	$3,292,311
6%	$4,288,867
7%	$5,395.088
8%	$6,620,401
9%	$7,974,904
10%	$9,469,411

This example assumed a straight annual annuity of $1,033,293. If instead the grantor had used a zeroed-out graduated annuity of $401,474 with a 20% annual increase the amount left after 10 years would be even more:

Total return	Amount Left at Trust Termination in 10 Years
3%	$1,990,495
4%	$2,980,308
5%	$4,076,531
6%	$5,288,174
7%	$6,624,890
8%	$8,097,009
9%	$9,715,580
10%	$11,492,414

Much ink has been spilled over the years about long-term vs. short-term GRATs. The short-term GRAT has the benefit of reducing the mortality risk that the grantor will die during the term, resulting in inclusion of all or part of the GRAT in the grantor's estate. But with interest rates as low as they are now, locking the current low interest rate into a longer term GRAT may make sense: the rolling sequential GRATs that I create in future years likely won't get the benefit of the extraordinary 0.6% June, 2020 rate. The mortality risk of longer terms can be hedged to some extent by creating several GRATs with different terms, say a three, a five, and a seven-year GRAT. Longer term GRATs also require smaller annuity payments and, if the grantor should die when interest rates have risen, less than the entire GRAT may be includible in the grantor's estate. For example, suppose I create a 20 year $10,000,000 GRAT at a time when the §7520 rate is 0.6%. The zeroed-out non-graduated GRAT amount is $532,096. Now suppose I die in 15 years, at a time when the 7520 rate is 7%. Using the inclusion formula in the §2031 regulations, the amount included in my estate is only $7,601,371 *no matter how large the trust has grown*.

Because a GRAT will almost always be a grantor trust for income tax purposes, GRATs can be carefully managed by buying assets or by substituting assets with greater appreciation potential, as well as to manage basis. And, of course, with asset values depressed, the appreciation potential of GRATs is now much better than in many past periods.

The Charitable Lead Trust in a Low-Interest Rate Environment

Much of the discussion of GRATs is relevant to charitable lead trusts, which are analogous to GRATs from an economic standpoint. Charitable lead trusts are essentially like GRATs with the annuity paid to charity instead of retained by the grantor.

A charitable lead annuity trust is the reverse of a charitable remainder annuity trust: it pays a lead annuity to a charity or charities for a term of years or a life or lives, with the remainder passing to family members. This is the opposite of the charitable remainder annuity trust, which pays the annuity to noncharitable beneficiaries with the remainder to charity. Because a charitable remainder trust accumulates undistributed income (both ordinary and capital gain) for eventual distribution to charity, the trust itself is tax exempt. That is not the case with a charitable lead trust, which is a taxable trust subject to the usual taxation rules applicable to trusts.

As seen above, the actuarial value of an annuity – i.e., the right to a fixed dollar amount rather than income – is the value of the income interest divided by the interest rate. Therefore, with a 3% §7520 rate the value of $1.00 of annuity for 10 years in the above example would be .255906 divided by .03 or 8.5302. To calculate the value of a $100,000 per year annuity I simply take the annuity factor of 8.5302 times $100,000, which makes the value of the annuity $853,020. The difference between this and the amount transferred to a charitable lead trust would be the amount of the gift to my remainder beneficiaries. Therefore, if a million dollars were transferred to the trust, the gift to the remainder beneficiaries would be $146,980.

Why are lead trusts required? Why not permit a person to set up a trust paying income to charity for a number of years, with remainder to family, and still have the lead interest qualify as a charitable interest for gift and estate tax deduction purposes? The reason is that Congress was concerned that grantors would invest the trust for low income, ignoring the interest of the charitable income beneficiary. Although the tables at the time these rules were enacted assumed a 6% income rate, Congress was worried that grantors would invest to achieve a much lower rate of return, thus overvaluing the charitable interest and undervaluing the interest transferred to family members. Therefore, since 1969, the rules have required that a charitable lead trust pay an annuity or unitrust interest rather than income interest to the grantor in order to qualify the charitable interest for the gift or estate tax charitable deduction. (As we will see, for income tax purposes, usually no deduction is allowed in any event.)

The economic analysis of charitable lead trusts is the same as with GRATs, which we have already looked at. As with GRATs, if lead trust investment return is in excess of the §7520 rate when the trust is established, then something will be left to pass free of estate or gift tax. If the trust will not outperform the §7520 rate, then the lead trust is of no advantage and may even overvalue the gift to the remainder beneficiaries. Charitable lead trusts work best, therefore, when interest rates are relatively low. And, as with GRATs, the annuity amount is usually expressed a fixed percentage of finally-determined fair market value of the contribution to the trust so it can adjust with changes in finally-determined value. This is very useful in the case of hard to value assets.

Basic Requirements of Lead Trusts

As noted above, the payment must be in the form of an annuity or unitrust interest. Although the regulations include detailed drafting requirements for charitable remainder unitrusts and annuity trusts, there is relatively little regulatory guidance for charitable lead trusts, although the IRS has provided useful sample charitable lead annuity trust forms for both inter vivos and testamentary CLATs. See Rev. Procs. 2007-45 and 2007-46. Many of the requirements applicable to remainder trusts do not apply to lead trusts. For example, there is no requirement that the payout be at least 5% of the initial fair market value (in the case of an annuity trust) or 5% of the fair market value as revalued annually (in the case of a unitrust). This makes sense, given the purpose of the 5% payout requirement for remainder trusts, namely, to prevent circumvention of the private foundation rules. Note that, unless the specific requirements, such as they are, are met, no income, gift, or estate tax deduction will be available for transfers to a charitable lead trust. Other differences from GRATs add flexibility. The CLAT annuity can increase, as can a GRAT annuity, but with a CLAT any payment structure is permitted as long as it is ascertainable. I could have an annuity that increases by more than 120% a year or that is very back loaded.

In explanatory notes accompanying the sample CLAT forms in Rev. Proc. 2007-45, the IRS noted:

> CLATs are not subject to any minimum or maximum payout requirements. The governing instrument of a CLAT must provide for the payment to a charitable organization of a fixed dollar amount or a fixed percentage of the initial net fair market value of the assets transferred to the trust. Alternatively, the governing instrument of a CLAT may provide for an annuity amount that is initially stated as a fixed dollar or fixed percentage amount but increases during the annuity period, provided that the value of the annuity amount is ascertainable at the time the trust is funded.

In Private Letter Ruling 201216045, the Service permitted ascending annuity payments over the 10-year annuity term. Among the rulings was this:

> 1. The terms of the charitable lead trust, as construed by the state court's order to permit variable ascending annuity payments, commencing on the decedent's death and continuing for the 10-year annuity term, will satisfy the requirements of §2055(e)(2) for a guaranteed annuity interest (i.e., an arrangement under which a determinable amount is paid periodically, but not less often than annually, for a specified term of years) and, therefore, property of the taxable estate of the decedent passing to the charitable lead trust will qualify for a charitable deduction under §2055(a).

Again, unlike the requirements for a charitable remainder trust, there is no requirement that a term of years trust be limited to 20. This is another case in which the requirements are different.

The private foundation excise taxes generally applicable to private foundations apply to charitable lead trusts. A special rule applies in the case of excess business holdings and jeopardy investments. In those cases, the sections do not apply unless the value of the lead interest exceeds 60% of the aggregate value of the trust assets. In the so-called "ghoul" or "vulture" trust, the term of the charitable lead trust is fixed to the life of an individual with reduced mortality (but not so reduced that the mortality tables are inapplicable) but whose age under the tables would produce a much greater valuation for the lead interest. This valuation abuse was dealt with in regulations made final on January 4, 2001. The proposed regulations provided that the only persons who could be used as measuring lives for a charitable lead trust were the donor, the donor's spouse, or a lineal ancestor of the remainder beneficiaries. The final regulations expand this class so that individuals who are lineal ancestors or spouses of lineal ancestors of beneficiaries may be used as measuring lives. The final regulations also added an actuarial safe harbor so that remainder beneficiaries with less than a 15% probability of receiving the trust remainder may be measuring lives. Collateral family members such as nieces and nephews can, therefore, be contingent beneficiaries under this more generous rule.

The charitable beneficiaries can be public charities or private foundations, and the non-charitable beneficiaries may be individuals or entities. In the case of an inter vivos charitable lead trust, special cautions are in order in two respects:

1. First, the donor should not retain the power to select charitable beneficiaries. This will cause inclusion in the estate for federal estate tax purposes.
2. Second, if the beneficiary is a private foundation of which the grantor is a director, this power indirectly to control charitable beneficiaries is also a power that will cause estate

tax inclusion. See *Estate of Revson v. United States*, 5 Cl. Ct. (1984). See also Rev. Rul. 72 - 552, 1972-2C.B. 525. In a number of private letter rulings, the Internal Revenue Service has ruled that charitable lead trusts will not be includible in the estate even if paid to a private foundation of which the grantor is a trustee, so long as those funds are isolated and the grantor does not participate in decisions as to distribution of those funds. A possible solution that should work is a distribution to a donor-advised fund at a community foundation. Because the donor's only powers are to make non-binding suggestions, the retention of this power should be permissible even though the donor is an advisor to the donor-advised fund.

Income Taxation Of Charitable Lead Trusts

The most typical kind of charitable lead trust, the non-grantor type, is subject to the regular rules of income taxation of subchapter J of the Code. To the extent income is distributed to charity, it is deductible under §642(c), which permits trusts a deduction for distributions to charity from gross income. Under a special rule, the deduction can be taken for a current year, even if the payment is made in a subsequent year, if the trustee makes an election under §642(c)(1). No set-aside deduction is permitted for charitable lead trusts as it is, for example, for estates or for revocable trusts that make an election to be treated as estates pursuant to §645. The tier system applicable to charitable remainder trusts has no counterpart in the taxation of charitable lead trusts, which (as noted above) are taxed like all other taxable trusts under subchapter J. Many charitable lead trusts provide that payments from the lead trust will be made in the least desirable form first, so that there is no question as to the nature of the income being distributed. Therefore, ordering provisions in many charitable lead trusts provide that income is distributed first from ordinary income, then from capital gains, then from unrelated business income, then from tax-exempt income, and finally from trust corpus.

If a trust makes a distribution in kind in satisfaction of a pecuniary amount, as will often be the case if distributions of appreciated property are made in satisfaction of the lead payment, the income realized on satisfaction of the pecuniary obligation will be carried out under §642(c) and be deductible by the trust.

Lead Trust Technical Requirements — Commutation

Commutation clauses would be very useful in a charitable lead trust because they would allow prepayment of the lead interest at a time when interest rates are high, thus depressing the value of the charitable lead annuity interest. Because of this "self-selection" ability of donors to take advantage of shifting interest rates, the Internal Revenue Service in Rev. Rul. 88-27 held that a charitable lead interest does not qualify as a guaranteed annuity interest under §2522(c)(2)(B) if the trustee has discretion to commute and prepay the charitable interest with a *discounted* payment. A charitable lead trust must therefore prohibit prepayment of the lead interest. However, in PLR 199952093 the prepayment was to be made without discount. If prepayment is without a discount, the charity is not disadvantaged, but actually benefited by receiving the funds early. Unfortunately, that does not necessarily mean the way is clear to provide for prepayment, even without discount, in the trust instrument. In PLR 199952093, as well as in PLRs 9844027 and 200225045, the prepayment power was not in the trust itself, but was later authorized by court order. Furthermore, the rulings did not discuss whether including a prepayment provision in the trust ab initio would prevent qualification of the CLAT: the rulings only dealt with whether the terminations would be taxable terminations, acts of self-dealing, or taxable expenditures under §§507, 4941, or 4945, respectively. The IRS sample forms mentioned earlier include a statement in the annotations, which is also reflected in the language of the form, that the trust does not qualify if the trustee has discretion to "commute and prepay" the charitable interest prior to termination of the annuity, citing Rev. Rul. 88-27.

Some of the language in Rev. Rul. 88-27 is concerning even in cases in which the prepayment is not discounted.[1] One of the two requirements of a charitable lead annuity trust noted in the ruling is that the annuity must represent the right to receive periodic payments over a specified period of time and, if the time can be changed, it is not payable over a specified period of time. "Under these circumstances, the interest does not represent the right to receive periodic payments over a specified period of time because the number of payments will be a function of whether, and to what extent, the trustee decides to prepay the charitable annuity."

Crown Income Charitable Fund v. Commissioner also is instructive.[2] In *Crown*, the Seventh Circuit Court of Appeals considered a charitable lead annuity trust that included a provision allowing prepayment of the lead interest if "as a matter of law" the trustees could do so. Affirming the Tax Court, the court held the trust did not qualify. The court viewed the phrase "as a matter of law" as requiring, before any commutation, a private letter ruling or judicial ruling but, at the time of the creation of the trust, the IRS was not issuing rulings on commutation by charitable lead trusts. Although it is tempting to include language permitting prepayment without discount if a ruling can be obtained, I think that is risky given the *Crown* case.

Lead Trust Technical Requirements—Excise Taxes

As noted above, the private foundation excise tax rules in §§4940 et. seq. apply to a charitable lead trust, except in some cases the excess business holdings and jeopardy investment restrictions of §§4943 and 4944. Those sections apply only if the actuarial value of the charitable lead interest is less than 60% of the value of all interests in the trust, valued as of the inception of the trust. An excess business holding is defined as including, among other things, an interest in a business enterprise only to the extent that the foundation and all disqualified persons own in the aggregate more than 20% of the voting stock. Note that, even in cases in which the interest is an excess business holding, a business interest received by gift or bequest can be held for up to 5 years after acquisition.

Grantor Lead Trusts

Most inter vivos lead trusts will be of the non-grantor type. In the typical non-grantor inter vivos lead trust the grantor does not retain powers over the trust that would cause it to be owned by the grantor for income tax purposes. No income tax deduction is available in the case of a non-grantor type lead trust created during lifetime. That is because §170(f)(B) provides that no deduction is allowed for the value of any interest in property other than a remainder interest transferred in trust unless the interest is in the form of a guaranteed annuity [or unitrust interest] and the grantor is treated as the owner of such interest for purposes of applying §671. The policy reason why a donor is not allowed an income tax deduction is that, in the case of a non-grantor trust, the donor is not taxed on the income of the trust. As a general rule of tax law, taxpayers are not allowed to deduct from income amounts that have never been included in income in the first place. The one great exception to this rule is the allowance of a deduction for the full fair market value of appreciated long-term capital gain property given to a public charity. In that case, the deduction is allowed for the unrealized capital gains even though the capital gains are not required to be taken into income. This policy reason for denying the income tax deduction is the same

1. The rulings do not discuss whether the ability to prepay the annuity renders the value of the lead and remainder interests unascertainable.

2. 8 F.3d 571 (7th Cir. 1993), *aff'g* 98 T.C. 327 (1992).

reason that a donor who permits a charity to use property rent-free does not receive an income tax deduction. If the donor were paid the rent by the charity and then endorsed the rent check back to the charity, the result would be a wash, which is the same result if no deduction is allowed in the first place and nothing is included in income.

In the case of a grantor lead trust, in which the grantor retains powers that cause the trust to be treated as though owned by the grantor for income tax purposes, the grantor is allowed a deduction the year the trust is established for the actuarial value of the annuity or unitrust income stream to be paid to the charity. The downside of getting the deduction is that, during the lifetime of the trust, the grantor will be taxed on the income of the trust even though the grantor does not receive the income. Still, this can be a useful technique for accelerating a charitable deduction into the year in which the grantor has unusually high income. For example, a grantor who makes $100,000 of charitable gifts each year anyway and who has a large gain from the sale of a business in a particular year may wish to establish a charitable lead trust that year to accelerate the deduction for the gifts that he will be making anyway in the future, into the current year. Because the gift is "for the use of" a charity, rather than a gift to charity, the percentage limitation would be 30% rather than 60%, even for cash gifts. Because of the uncertainties spawned by Private Letter Ruling 8824039, it is not clear that the unused part of the deduction is eligible for the 5-year carryover, although this is uncertain. If the trust is a grantor trust, the trust is simply ignored for all income tax purposes and the income is directly taxable to the grantor. The charitable deduction for distributions made to charities in future years, however, will not be allowed, because the donor has received a deduction for the discounted value of the income stream in year one.

Note that §170(f)(2)(B) requires that the grantor be treated as the owner of the income stream, but does not require that the grantor be treated as the owner of the trust corpus. Most grantor lead trusts are structured so the grantor is treated as the owner of the entire trust, but this is not a requirement. One advantage of the grantor lead trust, in addition, is that, if the trust has unrelated business income, the denial of the §642(c) deduction by §681 will not apply. However, private foundation rules do apply to a grantor lead trust. What happens if the grantor trust status ends? Remember that the price of getting the upfront charitable deduction was taxation on the trust income during the term. If the grantor trust status should end prematurely, however, the grantor will never pick up the income for the unexpired portion of the term. Therefore, if the grantor trust status ends for any reason, including the death of the grantor, the unrealized income for the rest of the term is immediately accelerated and picked up in the donor's taxable income. The amount of this additional tax, pursuant to §170(f)(2)(B), is an amount of income equal to the amount of any deduction received for the contribution, reduced by the discounted value of all amounts of income earned by the trust and taxable to the grantor before the time at which the grantor trust status ends. The amounts of income are to be discounted to the date of contribution. See Reg. § 1.170A-6(c)(4).

It is critical, in the case of a grantor lead trust (which, by definition, will always be an inter vivos trust), that the powers used to cause grantor trust status not also cause estate tax inclusion or violate the private foundation self-dealing rules. For example, a swap power held by the grantor will not cause estate tax inclusion but would violate the §4941 self-dealing rules. In addition, as noted earlier, some powers that will not cause grantor trust status for income tax purposes will cause estate tax inclusion, such as a right to select charitable beneficiaries or to determine, in the capacity of a director of a foundation, how funds distributed from a lead trust to the foundation will be further distributed. The grantor trust power used in the sample IRS forms is the power in a third person to swap assets. That IRS form also put to rest the question of whether §675 is triggered if a person other than the donor holds the swap power. This was questionable given the use of the word "reacquire" in §675.

The grantor lead trust has one other advantage from a transfer tax standpoint. Because the grantor will be taxed on income not received, additional amounts will be removed from the grantor's estate by virtue of the fact that the grantor will be paying someone else's income tax liability. However, this needs to be weighed against the fact that no income tax might be payable if the trust were able to deduct all of its income in payment of the lead amount. This comparison must take into account the income generated by the trust versus the amount expected to be paid in lead payments.

Non-Grantor Lead Trusts

Charitable lead trusts created at death will always, by definition, be of the non-grantor type. Charitable lead trusts created during lifetime may or may not be grantor lead trusts, as noted above. Many donors do not like the idea of being taxed on income they do not receive, and this is mostly appropriate as a way of accelerating a deduction into high tax bracket years. Non-grantor lead trusts have an additional useful application, namely a way of avoiding income tax percentage limitations for the especially generous donor. Some donors, either because they are very generous or because they have little taxable income (because of investments in municipal bonds) cannot deduct all of their contributions to charity. One solution is the non-grantor type lead trust. This does not generate a deduction, but the grantor is not taxed on the income, resulting in a wash. But a wash is the same result as if the donor were taxed on the income and then received a 100% offsetting charitable deduction. This is a very useful application of the non-grantor lead trust.

Generation Skipping Considerations

The generation skipping treatment of charitable lead trusts is complex, in part because Chapter 13 treats charitable lead unitrusts and charitable lead annuity trusts differently. For purposes of computing the exclusion ratio in charitable lead unitrusts, the basic rule of §2642(d) applies. The numerator of the applicable fraction is the amount of generation skipping tax exemption allocated, and the denominator is the amount transferred to the trust less federal estate or state death tax actually recovered from the property and less any deduction allowed. Thus, with a charitable lead unitrust, it is possible to know at the creation of the trust whether the distribution at termination will be fully covered by generation skipping tax exemption. In the case of a charitable lead annuity trust, however, amendments made in 1987 provide a special rule in §2642(e) for lead annuity trusts. In that case, the numerator is the amount of GST exemption allocated to the trust, but increased at the §7520 rate used to value the charitable deduction for the actual period of the term of the annuity trust. The denominator is the amount *actually in the trust* upon termination of the annuity interest. Thus, because it is unknown at the time the trust is created how well the trust's investments will perform, it is not possible to know in advance what the final treatment of the distribution will be.

Fortunately, one problem was fixed permanently. Take this case based on an actual situation: donor has no children and his primary beneficiary is a child of a deceased niece. Before the law was fixed, if the donor created a testamentary charitable lead trust terminating in favor of the child of the deceased niece distribution of the trust assets to the great-niece on termination would be a generation skipping transfer (a taxable distribution) even though a straight outright bequest at death to the great-niece would not have been. This was because, first, the predeceased child exception did not apply to non-lineal descendants and, second, because the predeceased child exception applied only to direct skips and not to taxable terminations. This problem has been fixed in two ways. First, §2651(e) was added to the Code for terminations, distributions, and transfers occurring after December 31, 1997. Before the 1997 Act revision, the Code, in §2612(c), provided only that direct skips to grandchildren were exempt if the parent of the grandchild was deceased. Now section §2651(e) applies the predeceased child exception to taxable terminations as well as to direct skips and, in addition, extends the predeceased child protection to collateral heirs – i.e., children of deceased nieces and nephews – so long as the transferor has no lineal living descendants. This will be very useful with charitable lead trusts, which are always treated as taxable terminations rather than direct skips.

Other Do-Now Techniques

Renegotiate Old Family Loans

These low interest rates also present an opportunity to renegotiate interest rates on notes arising from prior intrafamily sales. Renegotiation should not create gift tax issues — the obligee could always refinance at a bank.

Make Gifts of Depressed Assets

Assets values are depressed, so an obvious strategy is to make large taxable gifts now. This make makes sense anyway, to preserve exemption should the exemption snap back as is now scheduled in 2026.

Sell Depressed Assets to Family Members

Not only is future appreciation out of the estate, but the sale can be seller-financed at a very low interest rate.

Which brings us to….

Sales to Intentionally Defective Grantor Trusts ("IDGTs")

Another interest-sensitive technique that has been widely discussed is the sale of an appreciating asset to an irrevocable trust that is a grantor trust for income tax purposes and treated as owned wholly by the grantor, but that is not includible in the grantor's estate for estate tax purposes. If this technique works, it will serve as an effective freeze. A typical way of structuring such a trust is to fund it with some amount of liquid assets, wait a respectable period of weeks or months, and have the trust purchase the appreciating asset from the grantor for an installment note. The appreciating asset may generate income sufficient to pay off the note and, if it does not, the trust can borrow from a third party or payments on the note can be made in kind, much as with the typical GRAT. Because the trust is a grantor trust for income tax purposes, there is no income tax consequence to the sale and the transaction operates as an effective freeze. A sale directly to children would also effect a freeze, but at a capital gains cost. Because the required interest rate on the note is so low now, this technique works especially well today. For example the applicable federal long term interest rate for June, 2020 is only 1.01%.

Sale to Defective Grantor Trust Advantages

The sale to a grantor trust may be superior to a GRAT in several respects:

1. If the grantor dies during the term of a zeroed-out GRAT, usually the entire GRAT is includible in the grantor's estate. The GRAT only works if the grantor survives the term. Proponents of the sale to an intentionally defective grantor trust argue that, if structured correctly,

the trust should not includible in the grantor's estate regardless of when the grantor dies. This is a significant advantage.

2. The §7520 rate is used to calculate interest in split interest gifts. Unless the asset appreciates faster than the §7520 rate in effect in the month of the transfer, the GRAT will not produce satisfactory results. The interest rate on a promissory note used in an installment sale to an intentionally defective grantor trust is the §1274 rate. This rate is lower than the §7520 rate, so less value will be put back in the grantor's estate. Interest rates are so low now that sales in exchange for notes bearing a low interest rate are extremely attractive now.

3. Another advantage of the sale to the defective grantor trust is that it is easier for clients to understand. The GRAT is a complex concept shaped by complex tax rules.

4. Another disadvantage of the GRAT as compared to the sale to the intentionally defective grantor trust is that, during the estate tax inclusion period (or ETIP), no generation skipping tax exemption can be allocated to the GRAT. Until the GRAT term ends, no GST exemption can be allocated therefore. But with a sale to an intentionally defective grantor trust, there is no ETIP because the trust will not be includible in the grantor's estate and GST exemption can be allocated up front, when it is more advantageous.

5. Delayed and balloon payments may be possible with sales to an IDGT, whereas GRAT payments must be paid currently with no more than a 20% per year increase.

GRAT Advantages

On the other hand, the GRAT offers certain advantages. The GRAT is a creature of statute and regulations. It is specifically authorized by the Internal Revenue Code, and detailed regulations prescribe how the trust is to be structured and provide a drafting road map. The sale to the intentionally defective grantor trust lacks that kind of guidance and, over the years, authors have raised a number of unanswered issues and questions including the following:

1. It is possible that the Service may raise the argument that the grantor trust is includible in the grantor's estate for estate tax purposes on some kind of theory that the note payments, especially if they last for the life of the grantor, are in effect retention of a life income interest. There are good counter arguments to this, but it is at least an issue. Under state law it may be that creditors can reach the trust even if it is irrevocable and thus included in the grantor's estate. On the other hand, we know that the GRAT will be includible if the grantor dies during the term so that, if the length GRAT term and the note are the same, there is no difference between these two techniques from this viewpoint.

2. Another disadvantage of the sale to the intentionally defective grantor trust is that the GRAT is typically structured to produce a very small or no gift. With the intentionally defective grantor trust, however, many commentators feel that a seed money contribution to the trust in the range of 10% is necessary, although it is difficult to find authority upon which this conclusion is based, and a client may have an "old and cold" trust that fits the need.

3. If less than 10% or so of the asset's value is contributed to the trust up front, it may be that guarantees can be a solution, but this creates other gift tax issues, the answers to which are unclear.

4. Another concern Jeff Pennell and others have raised is that we do not know the income tax consequences of termination of the grantor trust status — for example on the death of the grantor. For example, is it possible that the sale is merely not recognized during the time of grantor trust status but that the gain is recognized at termination of grantor trust status, which may happen either at the death of the grantor or earlier? Although this writer believes the Service's position has been

pretty uniform that the grantor trust will simply be totally ignored for all income tax purposes, not everyone agrees with this reading.

5. Another concern is what happens if the trust property is undervalued and therefore the note is too small. Does that, again, cause estate tax inclusion? If so, can this be dealt with by a value definition clause? A valuation definition clause may be different than the kind of language prohibited by *Procter*. There the gift was simply undone. Here additional value will be paid, which will add to the grantor's estate. If the valuation definition clause includes interest, this should be distinguishable from *Procter*.

6. Finally, §2702 issues have been raised. Unless the note is considered a retained beneficial interest in the trust, it is difficult to see how §2702 could apply.

Many of these inclusion issues can be sidestepped if the note is paid off during the grantor's life. A self-canceling installment note may be an added refinement, especially if the grantor's life expectancy is great enough to use the tables but less than the tables would predict.

Private Annuities

With a private annuity, a transferor sells property to a family member in exchange for a promise of lifetime payments. Section 7520 rates and mortality tables are used to make the payments equivalent to the value of the property being sold. Private annuities are ideal for persons with less than average life expectancy but whose health is not so poor that they cannot be expected to survive a year. If the donor lives longer than actuarial life expectancy, unless the asset appreciates greatly the result may be worse than if there were no private annuity. As with a GRAT, the asset must appreciate faster than the §7520 rate in effect when the asset is sold, or the donor must die prematurely for this technique to work. An additional disadvantage is that any gain on the sale will be realized, although it will be spread over the donor's life expectancy. *See* Revenue Ruling 69-74 for an outline of the income tax rules for private annuities. Note that the advantageous rules of Revenue Ruling 69-74 will not be available if the annuity is secured. *See Estate of Bell v. Commissioner*, 60 T. C. 469 (1973). Can gain be avoided by structuring the private annuity with a trust, or will Chapter 14 apply?

The current low interest rates work to the benefit of private annuities. Take, for example, a 60-year old client with a $1,000,000 asset. If the asset is sold in exchange for a private annuity at a time when the §7520 rate is 5%, the amount of the annuity that must be paid is $82,320. At the June, 2020 rate of 0.6%, the annuity is only $50,269. For the right situation – especially a client not expected to live to life expectancy – the private annuity can be very effective. The private annuity also works well for assets expected to appreciate substantially. Of course the client must also not have a condition making it more likely than 50% that the client will die within a year. The reason that the private annuity payment is smaller when interest rates are low should be apparent by now. The right to $1.00 of annuity is worth more when interest rates are low because it isn't being discounted as much. I compute the amount of the annual annuity by dividing the annuity factor – the value of $1.00 of annuity – into the value of the property transferred, so the bigger the divisor, the smaller the resulting annuity.

Self-Canceling Installment Notes

The self-canceling installment note involves a sale to a family member in exchange for a note that provides for extinguishment or cancellation if the donor dies before the note is paid in full. *Estate of Moss v. Commissioner*, 74 T. C. 1239 (1980), *acq. in result in part,* 1981-1 C.B. In order to prevent a gift on the sale, however, the principal amount of the note or the interest rate must be increased to compensate for this self-canceling feature. Commercial software, including the author's, can calculate this premium. As with private annuities, the SCIN works especially well in cases in which the donor is not expected to survive the term of the note, but is not so afflicted that the mortality tables cannot be used to set the premium. Whether to use an interest or principal premium depends on income tax considerations of the buyer and seller. It is important that the donor not retain strings that could pull the property back into the estate, and that the term of the note be less than the seller's life expectancy to avoid §2036 issues and treatment of the transaction as a private annuity rather than as a sale. Unlike the private annuity, the self-canceling installment note can be secured. Note that, under *Estate of Frane v. Commissioner*, 98 T. C. 341 (1992), *affirmed in part and reversed in part,* 998 F.2d 567 (8th Cir., 1993), unrecognized gain at time of death will be taxable to the estate as income in respect of a decedent.

The premium that must be paid in order to prevent a gift for a self-cancelling installment note is less sensitive if the note is structured on a self-amortizing basis. That is more dramatically the case with an interest only note with a balloon.

Sales of Remainder Interests

With the sale of a remainder interest, the donor sells a remainder in an asset to a family member, based on actuarial values. Nothing is includible in the estate of the seller because only a life estate was retained. In cases of sales to family members, §2702 requires payment of full fair market value for the property, with certain exceptions such as the personal residence trust exception and the special rule of §2702(c)(4) regarding some assets of tangible personal property. The §2036 argument for includability, originally sustained by the courts in *Gradow v. United States*, 11 Ct. Cl. 808 (1987), *aff'd* 897 F.2d 516 (Fed. Cir. 1990), has been rejected by a number of appeals courts, including the Ninth Circuit in the *Magnin* case, 184 F.3d 1074 (9th Cir. 1999) and *D'Ambrosio v. Commissioner*, 101 F.3d 309 (3d Cir. 1996). Chapter 14 makes the sale of a remainder interest and the joint purchase much less effective unless non-family members such as nieces and nephews are parties.

OTHER CHARITABLE PLANNING IMPLICATIONS

Gifts Of A Remainder In A Personal Residence

The other gift that is particularly attractive given current low interest rates is a gift of a remainder in a personal residence or farm, with a retained life estate. With this gift, the donor deeds his or her personal residence to charity, reserving the right to live in the house for the remainder of the donor's lifetime. That retained use right is equivalent to an income interest and, when interest rates are low, that retained right is worth less actuarially. An income tax deduction is available for the actuarial value of the remainder. The lower the §7520 rate at the time of the gift, the greater the income tax deduction. To illustrate how dramatically interest rates affect this kind of gift, let us assume a donor, age 70, who deeds to charity a house worth $1 million, $500,000 of which represents the value of the land and $500,000 of which represents the value of the residence. If the gift had been made in a month when the §7520 rate was 5%, the income tax deduction would have been $465,850. If the gift were made now when the §7520 rate is 0.6%, the income tax deduction increases from $465,850 to $777,000. If two individuals age 70 made the gift (I am assuming a married couple with the house in joint name), the deduction increases from $345,245 to $711,575. Many suburban residences are more valuable for the land than the structure. In the tear down situation, in which more of the value is allocable to the land, the deduction is even higher.

ASSUMES VALUE OF RESIDENCE LESS SALVAGE VALUE = $500,000
HOUSE AND VALUE OF LAND PLUS SALVAGE VALUE = $500,000

Age	Interest rate				
	0.6%	3%	5%	8%	10%
60	$675,575	$437,580	$319,290	$213,600	$170,345
65	$727,250	$506,325	$388,340	$275,550	$226,310
70	$777,000	$579,040	$465,850	$350,265	$296,615
75	$823,405	$653,100	$549,355	$436,655	$381,245
80	$864,235	$723,350	$632,500	$528,095	$474,005
85	$898,250	$786,370	$710,345	$618,520	$568,690
60 & 65	$623,255	$360,480	$236,570	$133,105	$94,015
65 & 70	$680,115	$431,125	$303,540	$187,780	$140,280
70 & 75	$735,725	$508,190	$382,130	$258,395	$203,550
75 & 80	$788,170	$588,450	$469,585	$344,140	$284,470
80 & 85	$835,305	$667,135	$560,465	$440,350	$379,540

ASSUMES VALUE OF RESIDENCE LESS SALVAGE VALUE = $100,000
HOUSE AND VALUE OF LAND PLUS SALVAGE VALUE = $900,000

Age	Interest rate				
	0.6%	3.0%	5.0%	8.0%	10.0%
60	$839,627	$529,156	$377,946	$245,772	$192,741
65	$865,770	$590,625	$445,964	$309,910	$251,478
70	$890,712	$654,136	$520,450	$385,597	$323,755
75	$913,785	$717,460	$598,903	$471,259	$409,041
80	$933,951	$776,478	$675,556	$560,307	$500,961
85	$950,776	$828,626	$746,165	$647,000	$593,402
60 & 65	$813,419	$461,960	$298,666	$164,429	$114,539
65 & 70	$842,335	$526,321	$366,300	$222,900	$164,800
70 & 75	$870,329	$594,582	$443,218	$296,071	$231,478
75 & 80	$896,490	$663,946	$526,517	$382,524	$314,518
80 & 85	$919,821	$730,547	$611,101	$477,302	$409,908

And, for similar mathematical reasons, gifts to qualified personal residence trusts are less favorable now: when interest rates are low, the donor is deemed to have kept less. That works great for a charitable gift of a remainder in a residence and not so great with a QPRT gift of a remainder in a residence.

The Bad News

The bad news about the unusually low §7520 rate is that certain charitable gifts will now be less desirable than they were before. The income tax deduction for charitable gift annuity donors as well as donors to charitable remainder annuity trusts will be dramatically reduced. (Charitable remainder unitrusts are essentially unaffected by interest rate swings.) In addition, the unusually low interest rate creates certain traps for both charitable gift annuities and charitable remainder annuity trusts.

Charitable Gift Annuities

The tax law provides in §514(c)(5) that, in order for the charity's gain on the sale of a charitable gift annuity not to be taxed as unrelated business income, the value of the annuity must be less than 90% of the value of the property exchanged for the annuity. Some gift annuities for younger donors, *even those issued at American Council on Gift Annuities recommended rates*, may not pass this test. Under American Council on Gift Annuity Rates that became effective on January 1, 2020, ACGA rates will result in a charitable deduction of more than 10% if the §7520 rate is 1.8% or higher, whatever the payment frequency.[3] If the §7520 rate is less than 1.8%, the deduction will be less than 10% when annuitants are below certain ages. For example, the current recommended gift annuity rate for a joint and survivor annuity for 2 persons age 60 is 3.9%. Assuming quarterly payments, and applying the May 0.8% §7520 rate, the actuarial value of the charitable remainder is only 3.0%. It is important to make certain that gift annuities issued to these younger donors be reduced so that the actuarial value of the remainder is more than 10%. Because a charitable deduction is involved, the donor can elect to use a §7520 rate from one of the preceding two months, but that election may not be binding for §514(c)(5) purposes as that section refers to a 10% test done "at the time of the exchange" of property for the gift annuity.

One other point about gift annuities is worth making. Although the deduction on purchase of a charitable gift annuity is lower when the §7520 rate is low, the amount of each payment excluded from income under §72 will be higher. So a non-itemizer who cares more about how much income is taxable than about the charitable deduction will find the charitable gift annuity especially attractive now. This situation is much more common now that fewer people itemize under current tax law. Those donors should elect to use the lowest available §7520 rate.

Charitable Remainder Annuity Trusts

In addition to dramatically reducing the deduction for gifts to charitable remainder trusts, the low interest rate creates two possible traps. The first trap is that, under the tax law, a qualifying charitable remainder annuity trust or unitrust must have a charitable remainder with an actuarial value of at least 10% of the value of the property transferred to the trust. This test becomes much more difficult to pass, especially for annuity trusts, when interest rates are low. For example, at the June, 2020 0.6% §7520 rate, a 6% charitable remainder annuity trust for two individuals age 70 (again assuming quarterly payments) flunks the 10% test. In fact, the actuarial value of the remainder in that case is 0%. In addition, charitable remainder annuity trusts also must pass a separate test requiring that there be no more than a 5% probability that the trust will be exhausted before the charitable remainder vests. This test also becomes more difficult to pass when interest rates are low. For example, using the same example of two individuals age 70, even a 5% payout flunks the 5% exhaustion test, meaning that they can't create a CRAT at all. See the shocking chart below. It is extremely important that any charitable remainder annuity trust created pass both of these actuarial tests. The 5% exhaustion test does not apply to charitable remainder unitrusts or charitable gift annuities. It may be possible to avoid these actuarial traps by electing one of the two prior months' rates, but these rates may be with us for a long time, so in two or three months that option may not solve the problem.

3. New rates will become effective July 1, 2020.

YOUNGEST AGE AT WHICH A CHARITABLE REMAINDER ANNUITY TRUST QUALIFIES AT A 0.6% §7520 RATE[4]

Payout	Youngest Age
$5,000	77
$5,500	80
$6,000	82
$6,500	84
$7,000	85
$7,500	86
$8,000	88
$8,500	89

Opportunities Posed by the Recent Dip in Asset Valuations

When asset values decline suddenly, our clients panic. But this is the very moment when we can help out by reminding them that this is an opportunity to save transfer tax, and to devise transactions that will do so. Here's a list of some of those opportunistic transactions.

1. Gifts. Use those assets that have declined in value to make gifts to family members using the applicable exclusion amount. Any rebound in the value of the assets after the gift will be in the hands of the family member.

2. Sales. These assets that have declined in value make good subjects of sales to grantor trusts. There should be sufficient cash flow from the asset to pay off the purchase price debt so that the asset does not have to be sold to make the required promissory note payments. The sale could be between two grantor trusts as well. As noted recently in **Private Letter Ruling 202022002**, issued February 25, 2020, a transfer of an asset from one grantor trust to another grantor trust created by the same person is not recognized for federal income tax purposes because the two grantor trusts are both wholly owned by the grantor who created both trusts.

3. Allocation of Generation-Skipping Transfer Tax (GST) Exemption to Non-Exempt Trusts. If the client has made gifts to long term trusts in prior years, without sufficient GST exemption to allocate to achieve a zero inclusion ratio, now is the opportunity to allocate the increase in GST exemption, because the gift was made to the trust that has declined in value since the gift. This can be best illustrated with an example. Andy set up a very successful GRAT a number of years ago. When it terminated, the assets remaining in the GRAT were transferred to a dynasty trust for his five children and their descendants. He filed a gift tax return and allocated all of his remaining GST exemption to the dynasty trust but, due to the success of his GRAT, he did not have sufficient GST Exemption available to achieve a zero inclusion ratio. The assets in the dynasty trust have declined in value due to the recent dip in the market and Andy's GST exemption has now increased. Andy can now allocate sufficient GST exemption to his dynasty trust to achieve the zero inclusion ratio.

4. Late allocation of GST Exemption to 2019 gifts. When a gift tax return is timely filed, GST exemption is allocated to the full value of a gift to a GST Trust at the time the gift was made. On the other hand, with a late GST exemption allocation, the GST exemption is allocated to the GST

4. Assumes a trust contribution of $100,000 and quarterly payments made at the end of each quarter.

Trust on the basis of the then current value of the trust. The due date for a 2019 gift tax return is now July 15, 2020, which due date could be extended to October 15, 2020. If the value of the gift made in 2019 has significantly declined in value, a late GST exemption allocation could require a significantly lower allocation of GST exemption to achieve a zero inclusion ratio. This is best illustrated as follows. Barbara transferred $1,000,000 of marketable securities to her dynasty trust in 2019. The value of these assets has now fallen to $750,000. Barbara will file a timely gift tax return either on July 15, 2020 or October 15, 2020 to report her gift. Barbara will check the value of her dynasty trust and the anticipated trend in the market before the July due date to determine whether she should file her return at that time or wait until the October extended due date. If the value of the dynasty trust at time Barbara timely files her 2019 gift tax return remains below the $1,000,000 value of the gift in 2019, she will affirmatively "opt out" of automatic allocation of her GST exemption to this GST trust pursuant to Code §2632(c)(5). Barbara will then determine when to file another gift tax return for 2019 to make a late allocation of her GST exemption to the then value of the trust. Barbara should carefully follow the market value of the dynasty trust to determine when, after filing her timely gift tax return, she should file the additional return. Barbara can use the value of the trust as of the first of any month after timely filing her gift tax return for the amount of GST exemption to allocate to that dynasty trust on that late filed return as authorized in Treas. Reg. § 26.2642-2(a)(2) to achieve a zero inclusion ratio.

5. Gifts to Skip Persons. Another excellent use of GST exemption during a dip in the market would be to use those depressed assets for direct skips (that is, gifts outright to skip persons or to trusts whose beneficiaries consist solely of skip persons). This can be illustrated by 2 examples as follows: Example 1: Josephine has transferred significant wealth to her children over the years and now wants to do something for her grandchildren. With the dip in the market value of her securities, she plans to set up a skip person trust for her grandchildren to use some of her unused GST exemption. Example 2: Arthur has 4 grandchildren, 2 of whom are older and 2 of whom are under age 5. Over the years, Arthur had made gifts for the benefit of his older grandchildren so that the trusts for those older grandchildren have significantly greater value than the trusts that he just set up for his younger grandchildren. Arthur now plans to use his GST exemption for gifts of his depressed assets to the trusts for his younger grandchildren in order to equalize to some degree the value of those trusts with the value of the trusts for his older grandchildren.

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Discount Planning Debacle

Estate of Moore v. Commissioner

T.C. Memo 2020-40

Moore may be dismissed by some observers as a "bad facts make bad law" outlier that justifies a "nothing to see here" response. But there are at least two things to view in the court's opinion that may concern planners and drafters. One is a flawed denial of an estate tax charitable deduction based on a formula provision that is very much like a standard-issue "reduce-to-zero" marital deduction formula bequest. The other is an explication of the consideration-offset rule in §2043, applied after denying end-of-life planning that sought valuation discounts using a family limited partnership.

The first question that comes to mind after digesting *Moore* is why did the estate litigate this case? One answer might be that the government refused to settle, wishing to make law on several important issues. The other could be that the litigation was driven by the same aggressive planners (or the clients) who created the *Moore* mess in the first instance. There are at least two things to view that may concern planners and drafters. Fortunately, at least one of those things appears to entail error, raising the question whether the court erred on its own or whether those flaws in the court's results also were the product of litigation strategy gone bad. In the final analysis, perhaps the only ray of light is that *Moore* is a Memorandum decision, meaning that it is not citable as precedent. That won't prevent it from being a beacon in other cases with similar considerations.

The facts in *Moore* are important only in the main, showing how reckless (or foolish) optimism informed planning that was very unlikely to succeed. That planning did not begin until the 89-year-old decedent had a heart attack (attributed to congestive heart failure) and was given less than six months to live. He actually died in less than four months. While in hospice care, he compiled a list of goals that included wanting to retain control of his assets for life and reduce or eliminate federal estate taxes. Within days after being released from the hospital he created five trusts and an FLP that received an ownership interest in the decedent's farm (it was over 1000 acres at one time, prior to various conveyances to children). Oddly, that farm was sold outside the family, five days after it was transferred to the FLP, but the decedent arranged to retain a life estate in the farm following that sale. The result of these facts was §2036(a) inclusion of the undiscounted value of the farm in the decedent's gross estate – which defeated all of the other planning.

Prior to the sale, the decedent contributed the farm to a newly created FLP. Central to the §2036(a) result was the court finding that this transfer was not a bona fide sale for adequate and full consideration in money or money's worth. One rationale for that result was that the taxpayer was unable to establish legitimate and significant non-tax purposes for sale of the farm to the newly-created FLP. One reason offered to give this transfer "bona fide" sale status was that the FLP was created to manage the farm. Yet the FLP's sale to the outsider was negotiated before creation of the FLP or the decedent's transfer of the farm into it. And it was sold very shortly thereafter.

Another asserted nontax reason for creation of the FLP was protection against "liabilities, creditors, and bad marriages," but the decedent's surviving children could not identify any actual creditors (or even potential creditors), and none of their marriages was troubled – even 16 years later when the court rendered its opinion. Other asserted legitimate and significant nontax reasons for creation of the FLP were rejected as unsupported by the evidence. On this score there really *is* not much to see, here, other than how the estate's rote recitation of reasons was easily unpacked by the court.

Two of the five trusts that the decedent created were a funded, revocable, living trust and a charitable lead annuity trust (CLAT). This is important because an unusual provision directed the living trust to distribute to the CLAT a fraction of the living trust assets, probably designed to "discourage" audit of the rest of the estate tax return. The distribution clause reads like a traditional "reduce-to-zero" formula fractional marital deduction bequest. The numerator of the fraction was "the smallest amount which . . . will result in the least possible federal estate tax being payable as a result of my death," and the denominator was the value of the living trust as finally determined for federal estate tax purposes. The apparent intent was for this transfer to the CLAT to work like any formula marital bequest, to eliminate estate tax. As discussed below, the court concluded that this transfer did not qualify for the charitable deduction at all.

The FLP was owned 1% by a management trust, 1% by each of four children, and 95% by the revocable living trust, over which the decedent retained full control. Just weeks before the decedent died the revocable trust sold that 95% interest to another of the five trusts, this one irrevocable, for $5.3 million. The farm sold for over $16 million just weeks before, and the court (somewhat inexplicitly) represented that the sale price reflected a mere 53% valuation discount. Whatever is the proper math, the discount apparently attracted the government's attention.

The children became members of the FLP without seeking any legal advice, they did not negotiate any of the terms of the partnership agreement or their percentage ownership interests, and (according to the court) each "didn't have his own reasons for joining the FLP, but did it simply because [the decedent] asked them to." None of these were beneficial facts.

Of note to some readers who do this kind of work, even under extreme time pressure, was the $320,000 fee paid for the design of this plan, and another $475,000 for administration of the estate (virtually all the assets of which had been transferred premortem into the revocable living trust). Other extraneous facts included ostensible loans from the FLP to each child, for which no payments of interest or principal ever were made. Indeed, the children testified at trial that the planner "advised them that they need not make payments on the loans." The living trust's sale of its 95% FLP interest to the irrevocable trust also was for a promissory note for 95% of the alleged purchase price, on which no interest or principal payments ever were made.

Among the conclusions reached by the Tax Court (Judge Holmes) were that (1) the value of the farm was includible in the decedent's gross estate under §2036(a), as if the FLP was never created and the farm was never sold to the outsider, (2) the purported loans to the children instead were gifts, subject to gift tax, with §2035(b) inclusion of the gift tax payable on those gifts, and (3) a claimed deduction for the attorney fees paid for administration of the estate was unsupportable. Reading the opinion reveals little useful learning about any of those issues. But two other holdings are worthy of attention.

Denial of a Charitable Deduction

One of the two notable aspects of *Moore* was the court's denial of a charitable deduction for the formula gift from the living trust to the CLAT. This is not quite as simple as it might appear at first blush. The government argued that no deduction was available to the extent the formula would adjust to reflect any increase in the value of the decedent's estate, attributable to the government's audit of the estate tax return. The court agreed that "charitable deductions must be ascertainable at a decedent's date of death" and that postmortem increases in the value of the estate could not be reflected in the formula that produced the transfer for which a deduction was claimed. The court distinguished both *Estate of Christiansen v. Commissioner*, 586 F.3d 1061 (8th Cir. 2009), aff'g 130 T.C. 1 (2008), and *Estate of Petter v. Commissioner*, 653 F.3d 1012 (9th Cir. 2011), aff'g T.C. Memo. 2009-280, saying that it was unknown at Mr. Moore's death whether the CLAT would receive any assets from the living trust at all. The same could be said about the analogous marital deduction formula fractional gift on which this bequest was fashioned, and this holding is ripe for reversal on appeal.

Several aspects of the court's denial of the charitable deduction seem very wrong. But one reason for denying the deduction *does* make sense. The trust *was* deficient because the charitable transfer was triggered by an increase in the value of "any asset of this trust which is includible in my gross estate." This was not effective because the asset that was includible for estate tax purposes was not an asset of "this trust." But this drafting error was peculiar to *Moore*, and not of particular concern to most readers.

A second issue of more general interest was whether the charitable deduction was allowable under the formula provision used. In this respect the court was totally off base. It was correct for the court to say that a charitable deduction is allowable only if the amount is determinable as of the date of death and not dependent on future events. To support this statement the court cited cases such as *Estate of Marine v. Commissioner*, 97 T.C. 368 (1991), *aff'd*, 990 F.2d 136 (4th Cir. 1993). In *Marine*, the decedent granted discretion to his personal representatives to select and compensate persons who had contributed to the decedent's well-being. Because the number of those bequests was unlimited, the value of the charitable residue was not ascertainable at the date of the decedent's death. That uncertainty made the residue nondeductible, which was a correct holding.

In *Moore*, however, the postmortem event that the court viewed as nixing the charitable deduction was an audit by the Commissioner. The Tax Court said that the charitable bequest was ascertainable "only after an audit by the Commissioner, followed by a determination that additional property should be included in Moore's estate, followed by either the successful defense of that position or the estate's acquiescence to his determinations." The court believed that it was uncertain whether there would be any charitable bequest. This is no different than a marital bequest of the smallest amount needed to reduce the decedent's estate tax to zero. In the very typical formula-marital context there is no certainty that there will be any marital bequest, because the decedent's gross estate may be less than the unused exclusion amount. This does not disqualify the marital deduction for any bequest that finally is determined. And it should not disqualify the charitable deduction in *Moore*.

In addition, the Tax Court's distinction of *Christensen* and *Petter* also makes no sense. According to the opinion, in those cases the *amount* transferred to charity was subject to change (based on the formulas used), but the transfers *themselves* were not contingent on the happening of any event. By the court's reasoning, the *Moore* bequest was subject to an event: a government assertion of §2036 inclusion in the gross estate. Yet here is what the *Christiansen* court held on appeal, quoting the Tax Court analysis:

> That the estate and the IRS bickered about the value of the property being transferred doesn't mean the transfer itself was contingent in the sense of dependent for its existence on a future event. Resolution of a dispute about the fair market value of assets on the date Christensen died depends only on a settlement or final adjudication of a dispute about the past, not the happening of some event in the future.

That is exactly the case in *Moore*, too. It should make no difference whether inclusion as of the date of death is the trigger, rather than the value of the gross estate. Both cases turn on resolution of a dispute involving the ultimate size of the gross estate.

If the *Moore* court were correct (which it is not), then the formula-marital bequest in numerous standard estate plans simply would fail. A reduce-tax-to-zero formula marital bequest may turn on *either* valuation or includibility (e.g., whether a life insurance policy was transferred within three years of death, or gift tax was paid on gifts made within three years of death). Whether a dispute with the government entails an increase in size of the gross estate because of valuation or because of includibility should be irrelevant in *Moore*, just as it is for marital deduction purposes.

Application of the §2043 Consideration-Offset Rule

The other notable holding in *Moore* flows from §2036(a) inclusion of the date of death value of the transferred assets that went into the FLP, along with §2033 inclusion of the consideration received by the decedent in the transactions that were not effective to preclude application of §2036 (such as the consideration received by the decedent on sale of the *Moore* farm). As decided (with some controversy) in *Estate of Powell v. Commissioner*, 148 T.C. 392 (2017), the court applied §2043 in the context of the transfers that were sucked back into the gross estate by §2036. As illustrated below, this represents "double inclusion" because inclusion of the §2036 assets is in addition to §2033 inclusion in the estate of the value of assets received as consideration for the transfers that were ignored by the §2036 inclusion. Double inclusion – as if creation of the FLP was successful (§2033 inclusion) and as if creation of the FLP was not successful (§2036 inclusion) – is improper, and §2043 is designed to preclude that result.

Many practitioners, some with decades of estate and gift tax experience, are unfamiliar with §2043 because it is premised on an historically-unusual situation. Known as the "consideration offset" rule, §2043 is not well understood, probably because it hardly ever is taught and it was not applied by the courts prior to *Powell*. So even most experts have limited knowledge about it. Most advisors to transferors who trigger application of one of the so-called "string" provisions (§§2035-2038 and 2041) are accustomed to these rules being applied to a transfer made for *no* consideration. A common example is creation of a funded inter vivos trust with a retained life estate, power to control enjoyment, and a power of revocation. Indeed, most applications of the string provisions are entirely expected, and estate tax inclusion does not represent "double" taxation, because the inter vivos transfer was not a taxable gift for gift tax purposes and no consideration was received for the transfer. Thus, there was no "double" estate tax inclusion of what was transferred along with what was received (because nothing was received on the typical transfer).

This is not always the case, however. For example, it always is possible for §2043 to apply if, for example, a taxpayer sells stock in a closely held business and retains the right to vote that stock after the transfer, but only if the consideration received in that sale was less than adequate and full (a sweetheart sale for less than the fair market value of the stock transferred). Still, these kinds of transfers are not common.

The key to §2043 is an inter vivos transfer, that triggers inclusion under a string provision, for which consideration was received, but it was less than adequate and full compensation for the transfer. Historically these were *not* customary transfers, and §2043 was not on anyone's radar, until the government succeeded in generating inclusion of interests in an entity (such as a discount partnership), and taxpayers asserted that creation and funding of the entity was not a gift because consideration was received (in the form of an ownership interest in the partnership). With §2036(a) inclusion of the assets inside the partnership, the historical approach (as argued by the concurring opinion in *Powell*) was to ignore the entity and not pursue §2033 inclusion of the interest received on the creation. It was the lead opinion in *Powell*, as explained further in *Moore*, that concluded that nothing in the Code called for exclusion of the interest owned at death, meaning that the "double tax" situation arose for which the consideration-offset of §2043 provides relief.

Saying that *Powell* was the first application of §2043, and that it was an easy case, the *Moore* opinion notes that various elements of *Moore* will make the Rule 155 calculation difficult. As a result, the opinion leaves it for the parties to hammer out the details, making it a difficult opinion for learning purposes. Nevertheless, laid out in the opinion is a "formula" illustrating the operation of §2043, which basically boils down to inclusion of the §2036 value of the property unsuccessfully transferred by the taxpayer, plus inclusion of the *excess* of the value of the consideration received in the transfer (the FLP interest) over the value of the property transferred into the partnership. All of this is illustrated below.

One difficulty articulated by the court was that the value of the consideration received can appreciate or depreciate in the period of time between the transfer inter vivos and death, but the actual offset for the value of the consideration received is frozen at its date-of-transfer value. Further, identification of the consideration received may be difficult if any of that consideration is transferred by gift or by sale after the time of the deal and before the date of death.

The court also delved into issues such as payment of the attorney's fees, loans that purportedly were made, and the impact of the charitable deduction – none of which is difficult on its own but all of which make the bottom-line calculation uncertain. The court's closing sentence, referring to a Rule 155 calculation, confirms that "[w]e have no doubt that computations will be difficult."

Meaning that the parties must hash out the actual operation of these provisions and return with numbers for final approval. Thus, the calculation aspect is illustrated below, without using actual numbers from *Moore*. This is because those remain to be established. And the general information in the opinion is not sufficiently clear to rely upon.

For planners, the important aspect of this element in *Moore* is confirmation that (1) §2043 has been firmly embraced by the Tax Court, now in a second case, and (2) a taxpayer can be hurt if the consideration received (included under §2033) appreciates in value over its value at the time of the failed transfer (which is the subtraction under §2043). This too is illustrated below. It is a result of the following wording of §2043(a):

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

The notable elements of this are that (1) inclusion of the consideration is at date of death value, (2) it can be reduced only to zero (a negative number cannot be created), and (3) the consideration offset amount is based on value of the consideration at the time of the transfer, not at the time of death. As illustrated below, this means that the taxpayer can be hurt if the consideration appreciates between its receipt and death. As we also show, however, it can benefit the taxpayer if the consideration received declines in value. In cases like *Moore* this is not likely to be important, because of the very short time that elapses between the transfers and death. The same was true in *Powell*, for the same reason. The court's opinion in *Moore* simply shines a spotlight on the administrative difficulties created if other events (or inclusion and deduction issues) muck up the final determination of the value of the gross estate at death.

Calculations:

The §2043 element in *Moore* was first addressed by the Tax Court in *Estate of Powell*, which was a reviewed opinion with no dissent; 8 judges agreed with the opinion, 2 judges concurred in the result only but wrote no opinion, and 7 judges concurred in result only but joined an opinion rejecting application of §2043, as discussed in this summary.

The consideration offset rule is important for several reasons: one is obvious (because it now is being applied by the Tax Court), and the other is because its application can be seen as inequitable. Notably, the concurring opinion in *Powell* revealed that neither the government nor the taxpayer raised §2043 in that case; it was applied by the court on its own motion. *Moore* gives no indication whether it was addressed by the parties or, again, was raised by the court acting alone. Because the facts as revealed in *Moore* have not finally been established, the illustrations below utilize facts similar to those in *Powell*, which illustrate application of the full and adequate consideration exception.

The §2043 consideration offset rule is designed to prevent inappropriate double taxation. To preclude double taxation, §2043 provides that the consideration received in the transaction is excluded from the gross estate to the extent the transferred property is brought back into the decedent's estate (as if there never was a transfer). It refers to inclusion of only the "excess of the fair market value at the time of death of the property otherwise to be included on account of such transaction, over the value of the consideration received therefor by the decedent."

The problem is that the §2043 "offset" – it really works like a deduction that reduces the amount includible – does not work properly. This is because Congress did not impose a requirement to trace the consideration received, to identify it at death as the property that ought to be excluded if the transferred property is included. Instead, §2043 allows for all property owned by the decedent at death to be included in the gross estate – including any consideration received in the transaction – and then the value of the consideration that was received in the transaction is excluded by a reduction to the amount included under §§2035-2038 or 2041. The problem is that this exclusion is measured only by the value of the consideration received as of the date of the transaction, not the value of that consideration as finally determined for federal estate tax inclusion purposes. To do otherwise would require tracing the consideration received, which §2043 is meant to avoid.

To illustrate, assume that the property transferred into the FLP was worth $100x on the date of transfer, and that the consideration received was worth $99x on the date of the transfer. Also assume that each doubled in value over the taxpayer's remaining life. Includible at death will be the federal estate tax value of the consideration received and still owned at death – $198x – along with the full federal estate tax value of the property transferred – another $200x – which is then reduced by the consideration offset value of the property received at the time of the transfer – which was only $99x. The result is that all the appreciation in the consideration received remains includible in the gross estate. In some cases that growth on the consideration will be minimal, because the consideration received is a partnership interest with restrictions that limit the value for federal estate tax purposes, or in *Powell* or *Moore* because death occurred shortly after the initial transfers. But any appreciation in the property received is improperly includible in the gross estate. This is the result any time the consideration received is even a peppercorn shy of full and adequate. If §§2035 through 2038 or 2041 apply at all, the result is full inclusion of the transferred property, full inclusion of the consideration received, and the consideration offset is applied using date of transfer values. Using the figures just assumed, the calculation looks like this:

198x	§2033 inclusion
200x	§2036 inclusion
(99x)	§2043 offset
299x	Net amount taxable

Because the taxpayer actually owned the FLP interests at death, §2033 should include the full value of the interests that the taxpayer received and did not give away before death, which represents $99x received, and then a doubling in value to $198x by the time of death. By virtue of §2036, *also* includible is the estate tax value of the assets currently owned by the FLP, and then the Code ameliorates the double taxation issue through the §2043(a) offset.

So much ink has been spilled since *Powell* was decided, dealing with the double inclusion issue, that we may lose sight of the fact that a converse situation also may exist if the consideration received *declines* in value. In that case §2043 can work to the taxpayer's advantage, because the offsetting credit against the §2036 value that is included in the estate is larger than whatever amount of consideration remains in the estate at death. To illustrate, imagine that the consideration received declines in value between the date of a transfer and the date of death. Thus, taking the prior illustration, assume that the property transferred into the FLP was worth $100x on the date of transfer, and that the consideration received was worth $99x on the date of the transfer. Now assume that the consideration received declines to $90x on the date of death (but the transferred property did not change in value). The §2033 inclusion would be the $90x, the §2036 inclusion would be $100x, and the consideration offset would be $99x, leaving just $91x taxable in the estate. Using the figures just assumed, the calculation looks like this:

90x	§2033 inclusion
100x	§2036 inclusion
(99x)	§2043 offset
91x	Net amount taxable

This is better than the $100x that would have been taxable had this taxpayer done nothing.

Note, however, that the situation is not as favorable to the taxpayer if the property transferred declines in value. Here assume the same facts except that the property transferred into the FLP was worth $100x on the date of the transfer but is only worth $90x in the FLP on the date of death. The consideration received was worth $99x and is still worth $99x at the date of death. Now the §2033 inclusion is $99x, the §2036 inclusion is $90x, and the offset is limited to the same $90x – because the wording of §2043 includes the excess of the §2036 value ($90x) over the value of the consideration received ($99x), meaning that the §2036 inclusion amount effectively is reduced to zero but a negative number is not produced. The result is taxation of $99x, meaning that depreciation in the consideration received would produce a tax benefit for the taxpayer, but depreciation in the property transferred does not. Using the figures just assumed, the calculation looks like this:

99x	§2033 inclusion
90x	§2036 inclusion
(90x)	§2043 offset
99x	Net amount taxable

A final "extreme" case illustrates the point about the anti-tracing element of §2043. Assume again that the taxpayer transferred marketable securities and real estate to the FLP and received partnership interests in exchange. Assume that no gift was reported on that original transfer and that, notwithstanding the asserted no-gift character of this initial transfer, the government successfully argues that §2036(a) applies at the taxpayer's death and defeats the taxpayer's full and adequate consideration exception argument. Also assume that the taxpayer kept the partnership interests until years later when the taxpayer exchanged them for stock in X Corp., which then declared dividends in cash, dividends in stock, and declared a stock split. Meanwhile the taxpayer acquired Y Corp. using other wealth, and then X Corp. merged with Y Corp., after which they were bought by Z Corp., which issued Z Corp. stock in the deal. Thereafter the taxpayer sold the Z stock and invested the proceeds in Blackacre, and then swapped Blackacre for Greenacre, and finally purchased adjoining land to create Farmacre and ultimately made a fractional interest gift of an undivided interest in Farmacre (or incorporated Farmacre and gave stock in the new farm corporation).

Meanwhile the assets inside the partnership have grown and been invested and reinvested, so nothing looks the same at the taxpayer's death as it did at the time of the original transfer. The intended operation of §2036(a) is to ignore the transfer into the partnership and include the federal estate tax value of the transferred assets, as if the taxpayer never engaged in any of this. In this case the inclusion rule probably will be applied to the partnership the way it is applied to a trust in such a case, meaning that the value of the partnership assets held at death, reflecting all the partnership investment and reinvestment changes, will be includible rather than trying to identify and trace and value the actual assets transferred.

Then the simple rule in §2043 says to just apply all the federal estate and gift tax rules as if nothing was being included under §2036(a) and, to make everything right, reduce the gross estate by the value of the consideration received in the first transaction, valued at that time so there is no need to trace or identify or revalue it at death. That offset is meant to treat the decedent's estate as if nothing was received, and that exclusion/deduction/offset is the sole mechanism that is provided or available to make things right. The anti-tracing element allows everyone to ignore changes in the identity/investment of all the assets involved in the original transaction, which makes application of §2043 easier, but potentially inequitable. It also addresses the situation in which the consideration received is cash, which is untraceable.

There can be an added calculation complexity if a deduction is involved. This step was avoided in *Moore* because the government denied entirely its claimed charitable contribution. But it may be worth illustrating simply because it reflects a concern that has arisen in several FLP cases that involved the estate tax marital deduction, and it could arise in *Moore* if the Tax Court's improper denial of the charitable deduction is reversed (if there is an appeal). This issue, which has caused other taxpayers the most heartburn, entails an argument by the government that (1) the value includible in the gross estate under §2036(a) is the date of death value of the assets transferred into the FLP ($200x in the first example above), with no valuation discounts, but (2) the value for deduction purposes is the $198x discounted value of the FLP interests owned by the decedent at death and that are allocated in actual satisfaction of the deductible bequest. Denying a valuation discount for inclusion but respecting it for deduction funding purposes causes the estate to have phantom value that results in tax liability, notwithstanding an optimum formula marital or charitable bequest that is designed to reduce estate tax to zero.

Conclusion:

As illustrated in the FLP context, proper application of §2043 could be catastrophic, generating a result that is worse than if the taxpayer never engaged in the planning involved. Avoiding §2036 inclusion requires that the taxpayer never retained any interest or control, or divested it and outlived the §2035(a) three-year period, or received adequate and full consideration on the original creation of the FLP. Also note that, in a proper analysis, the "full and adequate" consideration evaluation is whether the taxpayer received an amount equal to the amount that would have been includible in the decedent's gross estate at death had no transfer occurred during life. See *United States v. Allen*, 293 F.2d 916 (10th Cir. 1961); *Estate of Pritchard v. Commissioner*, 4 T.C. 204 (1944). This means that any consideration received must be adequate to replace the wealth that would have been includible had the decedent done nothing during life. Thus, for example, with a life insurance policy, full and adequate consideration is not the interpolated terminal reserve or gift tax value but, rather, an amount equal to the full proceeds that would have been §2042(2) includible. All of this places extreme pressure upon discount valuation planning of the ilk involved in *Moore*, and shows why doing nothing – especially at the last minute – may be the best course of action.

LK/JP

Let Thy Property Go! §2036 and GRATs

Badgley v. United States

957 F.3d 969 (9th Cir. 2019)

In ruling on a Motion for Summary Judgment, the Court of Appeals for the Ninth Circuit sided with the government, affirming a district court determination that a grantor's retained rights to assets transferred to a "failed" Grantor Retained Annuity Trust (GRAT) triggered application of §2036.

The district court, in ruling on the government's Motion for Summary Judgment, concluded that (in the absence of questions of fact), all of the assets of the failed GRAT were to be included in a decedent's gross estate because the decedent died during the fifteen-year term of the GRAT. And, in a seemingly unsurprising opinion, the court of appeals agreed.

In *Badgley* the court pithily summarized §2036 as follows: "if a taxpayer does not let property go, neither will the taxman." The taxpayer in *Badgley* posited that, because GRATs and the rights inherent in them are not specifically mentioned in §2036 as the types of retained rights – possession, enjoyment, and right to income – that call §2036 into play, only the net present value of the unpaid annuity payments should have been included in the value of the estate. Both federal courts disagreed.

The court of appeals explained that Congress set forth three strings (possession, enjoyment, or a right to income) "tying" a decedent to property. Congress did not specify which property interests would trigger §2036. Instead, the court reasoned, Congress intended for courts to look to the result, "rather than the form those strings take." The opinion continues to explain that the fact that §2036 does not include the word "annuity" does not mean that annuities cannot be encompassed by §2036. [That's a lot of negatives!] In short, an annuity "fails" if the decedent dies during its term. Yet, as the court pointed out, quoting Texas estate planner John Bergner: "There is no solution to the problem of dying earlier than expected." And, when a GRAT's grantor dies during the term of the GRAT, the assets contributed to the GRAT, not just the value of any remaining GRAT payments that would have been paid in the absence of the grantor's death, are included in the value of the decedent's gross estate.

SLP

Intrafamily Loans Can Be Treated as Gifts

Estate of Bolles v. Commissioner

T.C. Memo. 2020-71

In this low interest environment, a low interest loan to a family member is a great estate planning tool. The loan freezes the value of the cash loaned so that, given the low interest rate, it has very little earning power in the hands of the family member lender. At the same time, the family member borrower has full use and enjoyment of the cash at an extremely low cost. The important questions to ask in structuring these intrafamily loans are (I) when are such loans looked at with suspicion by the government, and (II) when do these pass muster without further scrutiny. In *Bolles* the court provides some guidance on the requirements for valid intrafamily loans.

As stated by the court, the intention of the parties to the transaction is the principal determinant of whether a cash advance is a loan. That is, did the lender intend the funds to be repaid, and did the borrower intend to repay the funds. This intent is shown by the following 8 factors enumerated by the court: (1) existence of a promissory note, (2) interest is charged, (3) collateral is given to secure the loan, (4) a maturity date is stated, (5) actual payments are made on the loan, (6) one or the other of the parties to the loan keeps track of the payments and the balance due on the loan, (7) the lender reports the interest on the loan consistent with Federal tax law, and (8) the lender demands payment if the loan is not paid when due.

In this case, the decedent (Mary) made cash advances to her son Peter over the years in the total amount of $1,063,333 and recorded these transfers as loans. Peter made some payments on these loans early on, but did not make any payments after 1988. Mary continued to lend Peter the additional amount of $767,212 after 1988 even though at that time Peter was not making any payments on the loans and his ability to repay these amounts was in question due to financial difficulties he was having with his business.

Instead of demanding payment on the loan, Mary amended her trust to provide that the loans to Peter would be taken into account in determining the amount of Peter's share of her trust on her death, equalizing his share with what her other children were to receive. At the time she executed her trust amendment with this equalization provision, Peter provided her with an Acknowledgement of the existence of the loans, his inability to repay the loans, and agreeing that the amount of the loans together with interest at that applicable federal rate would be taken into account in determining his share of her trust on her death.

Mary's executor listed Peter's loans on the estate tax return at a value of zero due to the fact that the loans were uncollectible. Initially the government sought to revalue the loans at the principal amount loaned plus interest. In the alternative, the government claimed that Mary's loans to Peter were gifts and not loans. At trial, the government relied solely on its claim that the transfers were gifts and not loans and should have been reflected on the estate tax return as adjusted taxable gifts.

The court viewed Mary's cavalier treatment of the advances as sufficient to show that, once Peter no longer was making payments to her on his loans and was financially unable to repay the loan, her transfers were gifts and not loans. Mary no longer had an expectation of repayment, such expectation being crucial to a finding that the transfers were loans. Therefore, the court ruled that transfers to Peter from 1985 through 1989 were loans as this was prior to the time Mary realized the loans would not be repaid, and that the transfers to Peter after 1989 were gifts, when Mary could not reasonably have had an expectation of repayment.

In making intrafamily loans in this low interest environment, care needs to be taken to document the loans with promissory notes, on which interest is charged at least at the applicable federal rate. There should be some repayment of the note, such as payment of interest. And there should always be some indicia of the intention that the loan will be repaid.

KS

Inter Vivos Termination of QTIP Trust

Private Letter Rulings 202016002 – 006

The settlement agreement involved in these Rulings is not fully articulated. But we know that the decedent's surviving spouse was estranged from the decedent, challenged the decedent's estate plan, and ultimately settled "substantial litigation." Among other things, the surviving spouse received a cash distribution equal to the value of the spouse's life income interest in several inter vivos trusts that were created by the decedent and that qualified for the gift tax marital deduction under §2523(f) (QTIP trusts). The remaining balance in each trust was accelerated, passing to a trust for the benefit of a qualified charity.

The taxpayer-favorable conclusions in the PLRs were that (1) no tax was incurred by the spouse upon receipt of a distribution equal to the value of the spouse's income interests in these trusts, (2) termination of the trusts triggered §2519 gift taxation to the spouse of the value of the remainder interests in the QTIP trusts, but (3) the full §2519 value qualified for the §2522 gift tax charitable deduction, and (4) nothing would be includible in the spouse's gross estate at death under §2044.

The net result of triggering §2519 upon termination of a spouse's income interest in a QTIP trust is meant to accelerate estate tax inclusion of that marital trust under §2044, as if the QTIP trust was property actually owned by the spouse. This §2519 inclusion is coupled with a gift tax deduction that mimics whatever estate tax deduction might be available at the spouse's death, again as if the remainder in the QTIP trust was property owned by the spouse. Inter vivos termination of the QTIP thus is fundamentally the same as if the spouse owned the trust property and, in this case, made a gift of the value of the remainder interest to the qualified charity. All with gift tax treatment of the remainder interest to match or accelerate the estate tax treatment that would have applied at the spouse's death.

Normally §2519 is triggered when a surviving spouse makes an assignment of any portion of the spouse's income interest in a QTIP. The typical net result is acceleration of the estate tax treatment, which can be draconian because the spouse may assign only a smidgeon of the income interest but trigger §2519 taxation of the full value of the remainder in the entire trust. Here that was not a problem because the charitable deduction applied to that full remainder-interest value. And in some cases an intentional triggering of §2519 is desirable because it precludes application of §2044 when the spouse dies. This means that the spouse can accelerate the estate tax that otherwise would apply, and incur tax when the exclusion amount is at current levels (for example, before an anticipated reduction, such as that scheduled to occur in 2026). It also means that the spouse can cause taxation of the current value of the QTIP trust assets, which might be desirable if those values are artificially reduced (e.g., due to events such as the market reaction to the Covid-19 pandemic).

Because the income interest was not given away in this situation, no §2511 taxable gift was involved, and the value received by the spouse will inflate the spouse's gross estate at death, the same as if the spouse received that income over the balance of the spouse's remaining lifetime. The only interest in play in this situation was the remainder, subject to §2519. In other cases the spouse may trigger §2519 with a gift of a modest portion of the income interest, with a modest gift tax liability under §2511. But retention of any remaining portion of the income interest also would subject the spouse's estate to §2036(a)(1) inclusion at death of that portion of the trust in which the income interest was retained. This will not defeat the effort to accelerate use of the exclusion amount, but it likely will frustrate any discount valuation ploy (if values recover after the §2519-triggering event).

JP

State Estate Taxation of QTIP Trusts

Estate of Evans v. Dep't of Revenue

2020 WL 2764495 (Ore. Tax Ct.)

Several recent cases have addressed whether a state may tax a QTIP trust in the estate of the surviving spouse beneficiary if that state did not grant a marital deduction to the estate of the trust's settlor. The "contract" notion underlying the federal estate tax marital deduction is revealed by the basic requirement of all forms of qualified marital deduction transfer (outright, or in a general-power-of-appointment or QTIP marital trust), which is "payback" inclusion in the estate of the surviving spouse (under §2033, 2041, or 2044). Congress has, in effect, said that "We won't tax these assets in your estate, provided that you leave them in a form that will cause inclusion in your surviving spouse's estate." As a result, the marital deduction is not designed so much to reduce the estate tax for a married couple as it is to merely defer the tax until death of the surviving spouse.

The equity of this "payback" notion is illustrated *by In re Estate of Bracken*, 290 P.3d 99 (Wash. 2012), a state death tax case in which the court denied the State's effort to require inclusion of QTIP trust assets in the estates of surviving spouse decedents, because there was no state law QTIP marital deduction allowed (because there was no state death tax) in the estates of the trust settlors. These trusts *did* qualify as marital deduction QTIP trusts in the estate of the first spouse to die for *federal* estate tax purposes, and the *state* death tax was a piggyback on the federal inclusion. But having garnered no state death tax benefit in the settlor's estate, *Bracken* held that it was not appropriate for the State to seek payback inclusion when the surviving spouse died.

In response to *Bracken*, the Washington legislature amended its Estate and Transfer Tax Act to specifically tax QTIP trusts, regardless of when created or whether the state had granted a marital deduction in the estate of the settlor spouse. *See* Wash. Rev. Code §83.100.048. This amendment was upheld as constitutional in Estate of Hambleton v. Dep't of Revenue, 335 P.3d 398 (Wash. 2014), notwithstanding that it puts the payback "contract" in a different light than exists for federal estate tax purposes.

Consistent with the Washington legislation, *Estate of Ackerley v. Dep't of Revenue*, 389 P.3d 583 (Wash. 2017), subsequently held that federal gift tax included in a decedent's federal gross estate under §2035(b) (the so-called "gross up" rule) also is subject to state estate tax, because the state tax piggybacks on the federal taxable estate. Essentially these developments reveal an effort to tie state estate tax to the federal estate tax return, making whatever is includible for federal purposes also includible for state estate tax purposes. And they indicate that the state death tax posture is fundamentally different than that at the federal level.

In *Estate of Brooks v. Comm'r of Rev. Servs*, 159 A.3d 1149 (Conn. 2017), the settlor of two QTIP trusts died in Florida, which has no state estate tax. These trusts qualified for the federal estate tax marital deduction but served no state death tax deferral function, because there was no state death tax to be deferred. The surviving spouse relocated to and died in Connecticut, which *does* have an estate tax. These QTIP trusts didn't garner any deferral of Connecticut estate tax (or any other estate tax benefit in Connecticut), because the trust settlor did not die in Connecticut. Nevertheless, Connecticut imposed its estate tax on these QTIP trusts when the surviving spouse died, based on the logic (in both *Bracken* and *Ackerley*) that the state estate tax piggybacks on the federal gross estate and QTIP trusts are includible in the federal gross estate of a surviving spouse. The lack of deferral and notions of payback notwithstanding, the court also stated that termination of the surviving spouse's life estate is a "sufficient 'shifting at death of particular incidents of property' to properly impose an excise tax" on the transfer of wealth.

As decided below, *Comptroller of the Treasury v. Taylor*, 213 A.3d 629 (Md. 2019), *rev'g* 189 A.3d 799 (Md. Ct. Special App. 2018), was contrary to *Brooks* (although never citing it). The settlor died in Michigan, created a QTIP trust, and a QTIP election was made for both state and federal tax purposes. The surviving spouse died in Maryland, which has an estate tax. Nevertheless, the lower court held that the QTIP trust was *not* includible in the survivor's estate for Maryland estate tax purposes, notwithstanding that it was includible for federal purposes. That decision subsequently was reversed by Maryland's high court, which concluded that federal inclusion of the QTIP under §2044 was definitive for state death tax inclusion.

A dissenting opinion in *Taylor* stated the obvious case: because no marital deduction was granted by Maryland in the estate of the decedent's predeceased spouse, there was no "quid pro quo" to justify taxation in the estate of the surviving spouse. "The QTIP deduction is premised on an exchange of benefits between the surviving spouse and the government granting a tax deferral. . . . [The surviving spouse] received no benefit from the State of Maryland that could justify subjecting the QTIP assets to the Maryland estate tax." And then, based on a constitutional-nexus argument, the dissent also concluded that "[a]ssessment of a Maryland estate tax on a trust that is not located in Maryland and has not been afforded the protection of Maryland law contravenes the Fourteenth Amendment."

Perhaps this Constitutional argument in *Taylor* was the impetus for the taxpayer's argument in *Evans*, which involved the same issue of piggyback inclusion of a QTIP trust in the Oregon estate of a deceased surviving spouse. The conclusion was the same, but the court's analysis was addressed entirely to the taxpayer's assertion that Oregon taxation of the QTIP trust violated the Due Process Clause of the United States Constitution.

The United States Supreme Court undertook the nexus question for purposes of state *income* taxation of trusts in *North Carolina Department of Revenue v. Kaestner 1992 Family Trust*, 139 S. Ct. 2213 (2019). *Evans* confronted the nexus question for state *wealth transfer* tax purposes. Only the surviving spouse had a connection to Oregon and her only interest in the QTIP trust was the right to receive income, annually. Neither the settlor, the trustee, the remainder beneficiaries, nor the trust itself had any connection to Oregon, yet the Oregon court concluded that there were sufficient minimum contacts and rational relation between the trust and the State for tax purposes. In the process it distinguished *Kaestner*, saying that insufficient contacts existed in *Kaestner* because the beneficiary "had no present right" to trust benefits "because her ability to enjoy either income or corpus of the trust was at the complete discretion of a trustee who had never distributed to her any amounts from the trust." In contrast, in *Evans*, the spouse "had an exclusive lifetime interest in the trust . . . and received substantial payments from the trust." The final conclusion in *Evans* was that "inclusion of the trust property in [the surviving spouse's] estate does not violate the federal Due Process Clause because [the surviving spouse] had an exclusive lifetime interest in the trust property and was an Oregon domiciliary at the time of her death."

This is no different than the fundamental notion articulated in both *Brooks* and *Taylor*, that the law of the surviving spouse's domicile at death is the applicable law for purposes of the state death tax imposed, regardless of any federal payback concept. That notion merits consideration when planning the estate of a surviving spouse, which (as between the two spouses) is the estate in which tax liability is more likely to be incurred. Planners customarily think about planning a client's domicile to minimize state *income* taxation. These decisions confirm that planners also should consider state domicile for *wealth transfer* tax minimization purposes, which can change after the death of the first spouse to die. Indeed, changing a surviving spouse's domicile might be easier than would be a change of domicile for the married couple while both spouses are alive.

JP

Taxpayer Finally Wins a Conservation Easement Case

Champions Retreat Golf Founders, LLC v. Commissioner

2020 WL 2462534 (11th Cir.), rev'g TC Memo 2018-146

As we have long seen on these programs, taxpayers rarely win conservation easement cases, and it took a reversal of the Tax Court by the Court of Appeals for the Eleventh Circuit to nab the taxpayer victory this time. The taxpayer-LLC acquired undeveloped land along the Savannah River and Little Rivers and developed a golf course with three 9-hole courses — one each designed by Gary Player, Jack Nicklaus, and Arnold Palmer. The course was always and still is private — open only to club members and their guests, not the general public. The conservation easement was granted over undeveloped land as well as the golf course, including the driving range, but not including the golf course buildings and parking lot. Various parts of the property were populated by abundant species of rare birds, plants, and animals. But public access is a basic requirement of a valid conservation easement and it was this requirement that doomed the taxpayer in the Tax Court, which held:

> And, because of the limited physical access, the public could view the easement area only from the Savannah and Little Rivers, so visual access is limited to the areas adjacent to those rivers. The extent to which the general public can see the easement area from the rivers is limited further by the 3- to 10-foot river banks. Finally, uncertainty persists regarding public access to the Little River. Thus, we conclude that the contribution of the easement area was not for the scenic enjoyment of the general public.

The Court of Appeals saw it differently, emphasizing that the regulations provide that the general public need only have visual, not physical, access to or across the property. Treas. Reg. §1.170A-14(d)(4)(ii)(B). The entire property need not be visible to the public, but the public-benefit requirement is not met "if only a small portion of the property is visible to the public." This court held:

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

LK

Perpetual Conservation Easements

Oakbrook Land Holdings, LLC v. Commissioner

154 T.C. No. 10 (2020); T.C. Memo 2020-54

Two opinions were issued on the same date deciding various elements of the controversy in *Oakbrook Land Holdings*. The more direct government victory is the Memorandum decision, which denies the taxpayer's claimed charitable deduction for a dedicated conservation easement. The more difficult decision favoring the government is the reported decision, which is a reviewed decision with 12 judges joining the majority opinion, another 4 concurring separately, and a single judge writing in dissent. That dissenting judge is the one who decided the underlying case and who wrote the Memorandum opinion, which was decided in favor of the government. So, writing in dissent to the reviewed opinion also in favor of the government makes this a bit odd, first because not many reviewed Tax Court cases are decided and second because the judge writing in dissent actually favored the government in the particular case.

The underlying conservation easement deduction was denied on the same grounds that have been relied upon in multiple prior cases, many involving several of the same players. (A hint for the inter-relation of many of these cases is that multiple recent cases all have the word "Holdings" in the taxpayer's name, and the charitable conservation easement was granted in each case to the Southeast Regional Land Conservancy.) The specific glitch resulting in many millions of lost deductions appears in deeds that, in each case, relied on drafting by the Conservancy, which provided standard language for all of its conservation easements. A footnote in the Memorandum opinion states that "there is reason to believe thousands of conservation easements have similar language." Which means that, for taxpayers engaged in this arena, the particular flaw is significant.

In particular, the controversy involves a so-called "extinguishment" clause, which distributes any proceeds received in exchange for the conserved property upon an event such as condemnation, or an insured loss. Compensation received in exchange for the property must be shared by the owner of the underlying property and the conservancy, as mandated by Treas. Reg. §1.170A-14(g)(6)(ii). This sharing mandate is part of the "perpetuity" requirement found in §170(h)(1)(C) and (h)(5)(A). The regulation is the crux of the case that was decided by the reviewed opinion. It addressed an argument by the taxpayer that the regulation is invalid. The full court disagreed with that assertion and upheld the regulation.

As litigated, the flawed provision specified that the Conservancy would receive a fixed dollar amount of any proceeds, essentially equal to the value of the easement at the time the deed conveyed the easement. The executive director of the Conservancy testified that he did not think it was right for the Conservancy to share in any proceeds attributable to improvements made by the donor after contribution of the easement. So the clause as drafted provided that the proceeds would be reduced by the value of donor-improvements made post-contribution and only the balance would be divided. The regulation instead requires that the charity receive a pro rata portion of the proceeds and that the pro ration must consider the value of the entire property at the time the proceeds are received, including any value attributable to improvements made by the property owner after dedication of the easement.

Because the actual provision in the subject case did not provide for a pro ration of any kind, the Memorandum opinion concluded that the deduction was not allowable and did not need to reach the issue that was central to the reviewed opinion. Although the judge deciding the underlying case thought that the challenged regulation was infirm under the Administrative Procedure Act (APA), his decision on the particulars of this case was mandated by the reviewed opinion's conclusion that the regulation is valid. As such, the taxpayer was not entitled to the deduction claimed.

Any student of conservation easements should study the Memorandum opinion, about which more could be written. For the vast majority of our registrants, however, no more needs to be said in this forum. A little more might be said about the reviewed decision regarding the APA, rejecting the taxpayer's challenge to the regulation itself. However, again our sense is that those who care will study these opinions with a great deal of care and that the vast majority of our registrants need no more than the following light brush.

As promulgated by the court, the majority opinion of the reviewed decision is over 30 pages in length. The concurring opinion, and the dissent, both are over 40 pages in length, so there is much to study and argue about in terms of the fundamental question of how regulations are promulgated and whether a challenge to any regulation is likely to succeed. Some readers may find that the dissenting opinion is the most persuasive. It might come as no surprise if, on appeal (which would be to the Court of Appeals for the Sixth Circuit), the dissent garners more support than either of the other two opinions. It seems likely that the dollars involved in this and many other cases with the same fundamental issue will dictate appeals in multiple circuits. As the dissent said in closing, "who knows how many other conservation-easement deductions" turn on this issue.

Here is the crux, as we understand it. The regulation addresses an issue of substantive importance with conservation easements. Underlying the multiple cases involving conservation easements is the government's concern that syndicated investors are purchasing property for much less than the value they place on it for deduction purposes, and that at some time after the deduction is allowed the parties – investors and conservancy together – will find a way to terminate the easement and go their separate ways.

The "perpetuity" requirement imposed by Congress lacks specificity, so the regulation is meant to fill in the gaps. As such, it was regarded by majority and dissent as a "legislative" regulation, which is important because there are differing standards by which such a regulation is judged versus an "interpretive" regulation. The crux of the validity controversy is the question whether Treasury received a comment in response to its request for public review to which it did not provide a response, specifically regarding the particular issue involved (how to account for donor improvements after contribution of the easement). That triggered the potential application of 5 U.S.C. §706(2)(A), which is the APA requirement that an agency action be set aside if it is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."

On the question whether Treasury's failure to respond to that comment rose to that standard, the majority concluded that Treasury "clearly considered the comments it received on the . . . point" and the dissent believed that it did not satisfy the applicable APA requirements. The concurring opinion actually appears to agree with the dissent on this point. Registrants with any sort of controversy regarding the validity of a Treasury regulation will find the various points of view expressed to be enlightening. As is the majority's recitation that "[t]he regulation . . . was promulgated in January 1986. It has never been amended. In the past 34 years Congress has amended section 170 more than 30 times, but these amendments have never suggested any disagreement with the construction of the statute that Treasury adopted in" the subject regulation. This "old-and-cold" logic, that Congress had sufficient time to object if the regulation deviated from Congressional intent, feels like a hollow claim, given that it seems particularly unlikely that anyone on Capitol Hill reads the regulations with an eye to discovering and then changing interpretations like the one in question. After all, in this case, only one comment (out of hundreds by an industry experts) focused on the particular issue.

No matter, for planners who represent donors of conservation easements. The important message today is to eschew the flawed provision in the document drafted by the Conservancy. Forewarned is forearmed.

One final observation may be relevant. The Conservancy apparently thought that the critical provision was copacetic, based on a single parenthetical in a single PLR issued to a single taxpayer in 2008. No advisor reading a PLR can be unaware of the caution always expressed that PLRs are not authority on which any other taxpayer may rely. If indeed this was the rationale upon which such a momentous drafting decision was based, then it underscores the folly of reliance on PLRs in the first instance. It also raises the question why the Conservancy did not obtain its own PLR blessing the provision. The consequences of this one drafting decision will be far reaching and affect many donors. As the dissenting opinion suggests, it is likely to generate appeals in multiple circuit courts of appeal. It may be worth watching by only those drafters who deal with conservation easements, but the lesson it sends to drafters everywhere is sobering.

LK/JP

IRS Offers §170(h) Guidance

Generic Legal Advice 2020-001

On March 17, 2020, the IRS Office of Chief Counsel released a memorandum giving generic legal advice regarding Code §170(h). The advice was directed to a senior level counsel from an associate chief counsel. So what is "generic legal advice?" As the IRS explains in its manual:

> When an issue arises in a number of cases that affects an industry segment or there is a need to address a legal issue as it relates to an amalgamated set of facts, it may be desirable to have an Associate Chief Counsel executive whose office is responsible for the issue sign a generic legal advice. This type of advice is in contrast to issuing non-taxpayer specific legal advice at the branch level. Generic legal advice might be appropriate, for example, where a common set of material facts applies to a significant number of taxpayers, and advice with respect to facts representative of those common material facts will assist the Service in resolving the cases more efficiently than advice applicable only to a specific taxpayer.

The issue addressed in the memorandum was whether a conservation easement fails to satisfy the requirements of Code §170(h) as a matter of law if it contains an amendment clause. The conclusion was that an amendment clause does not necessarily cause the easement to fail the §170(h) requirements. An amendment clause must be considered in the context of the deed as a whole and the surrounding facts and circumstances to determine the parties' rights, powers, obligations, and duties. This determination requires a case by case analysis. After expressing the caveat that the inquiry is based on the deed as a whole and the surrounding facts and circumstances, the advice gave an example of a provision that was compliant with the perpetuity requirements of §170(h):

> Grantee and Grantor may amend this Easement to enhance the Property's conservation values or add real property subject to the restrictions set forth in this deed to the restricted property by an amended deed of easement, provided that no amendment shall (i) affect this Easement's perpetual duration, (ii) permit development, improvements, or uses prohibited by this Easement on its effective date, (iii) conflict with or be contrary to or inconsistent with the conservation purposes of this Easement, (iv) reduce the protection of the conservation values, (v) affect the qualification of this Easement as a "qualified conservation

contribution" or "interest in land", (vi) affect the status of Grantee as a "qualified organization" or "eligible donee", or (vii) create an impermissible private benefit or private inurement in violation of federal tax law. No amendment shall be effective unless documented in a notarized writing executed by Grantee and Grantor and recorded in the Clerk's Office of the Circuit Court of [County, State].

LK

Fiduciary Liability for the Payment of Tax

United States v. Marin,

2020 WL 378094 (S.D. N.Y.)

Of great interest to our clients who serve as fiduciaries, or who are beneficiaries of a decedent's estate or trust, is whether, under what circumstances, and to what extent they can be held liable for Federal estate tax resulting from the property they administer or receive as a result of a decedent's death. This issue was at the core of the court's ruling on the taxpayer's motion to dismiss in *Marin*, in which the court reviewed in detail some of the pitfalls found in the United States Code ("U.S.C.") for fiduciaries and beneficiaries that might result in personal liability.

The executor in *Marin* who filed the estate tax return elected to defer payment of estate tax under §6166, but only made interest payments during the first five years before ceasing all payments. The estate also failed to provide a bond or consent lien on the estate's property. As a result, the government terminated the estate's installment payments. Even though the estate earned substantial income, the estate also had failed to file fiduciary income tax returns. On the decedent's death, each of the decedent's three children received direct distributions from several of the decedent's accounts, and one child made personal use of certain real estate belonging to the estate.

Many practitioners are unfamiliar with one provision of the U.S.C. that is not found in the 26 U.S.C. (the Internal Revenue Code). Rather, it is 31 U.S.C. §3713, giving claims of the U.S. government priority for payment. This statute further provides that a fiduciary will be personally liable for the payment of the government's claim if the fiduciary pays other debts before paying the known claim of the U.S. government and thereafter the fiduciary is unable to pay the government's claim. The *Marin* court noted that the executor of the Marin estate knew of the obligation to pay the tax owed by the estate, but paid debts owed to others while deferring the payment of the estate tax. When the deferred estate tax was due to be paid, the value of the assets in the Marin estate had declined to such a degree due to vagaries of the market that the estate was no longer able to pay the estate tax. The *Marin* court found these facts sufficient to state a claim for personal liability of the fiduciary for the unpaid tax under 31 U.S.C. §3713.

Another avenue of exposure to personal liability of the fiduciary for payment of tax is a plain vanilla breach of fiduciary duty claim. Here, the *Marin* court recognized the fact that an executor of an estate is "the fiduciary of its creditors as well as legatees and distributees." The breach can arise from making payments to others in violation of the preferential rights of the government, or from the executor's self-dealing use of estate assets. Here, the government alleged that the executor of the Marin estate did both, and made sufficient allegations to state a claim for breach of fiduciary duty.

Then there is transferee liability under Internal Revenue Code §6324(a). Section 6324(a)(1) creates a lien for estate tax on all of the property constituting the decedent's gross estate at the time of the decedent's death, until the estate tax is paid in full or until ten years from the date of the decedent's death. Section 6324(a)(2) then imposes personal liability for the estate tax on any transferee or trustee (or others) who receives or possesses such property at the time of death, to the extent of the value of the property at that time. Often misunderstood is that transferee liability under §6324(a)(2) is in addition to transferee liability under §6901. In addition, unlike §6901, §6324(a)(2) transferee liability does not require an assessment of liability against the transferee prior to the government being able to pursue personal liability for the tax under §6324(a)(2). Furthermore, the discharge of a fiduciary from personal liability under §2204 does not eliminate the estate tax lien imposed by §6324(a)(1) or the potential for personal liability under §6324(a)(2).

The operation of the lien created under §6324(a) is also distinct from the operation of the lien created under §6321, which imposes a lien for the payment of the estate tax. But pursuant to §6322, the §6321 lien is imposed at the time the tax is assessed and then only on property in the estate at that time. Section 6324(a), on the other hand, is much broader and imposes a lien on all property comprising the decedent's gross estate at the time of the decedent's death.

Each of these sections of the U.S.C. creates personal liability potential for the fiduciaries we represent. If there is any Federal tax liability of the decedent, such as income tax liability or gift tax liability, or of an estate or trust, such as estate tax liability or GST tax liability, a fiduciary may be personally liable for the payment of such tax if the fiduciary, with knowledge of the tax, distributes assets or pays claims prior to paying such tax, leaving the fiduciary without sufficient assets to satisfy the tax. This is especially problematic in today's volatile market environment.

For example, assume a decedent died in November of 2019 with a gross estate of $7,000,000, having made prior taxable gifts of $11,000,000. The estate tax on the decedent's taxable estate would be $2,604,000. The decedent provided in her trust for specific gifts $3,000,000 to individuals and charities, with the balance going to her children. Believing the $7,000,000 sufficient to pay the estate tax due, the trustee promptly satisfied these specific gifts. Then in March of 2020, the value of her remaining assets declined by 50% to $2,000,000. If the value of the trust does not increase sufficiently to pay the estate tax of $2,604,000 by the due date of the estate tax return in September, the trustee will be personally liable for the unpaid estate tax under 31 U.S.C. §3713 because the trustee violated the priority given to the Federal government by that statute. The trustee also would be liable for the estate tax under §6324(a) because of the lien on the property of the trust created by that section and the personal liability imposed on the trustee under that section for the payment of the tax to the full extent of the value of the property in the trust at the time of the decedent's death.

Advising our clients on the various avenues of personal liability when administering an estate or trust is central to adequate representation of our fiduciary clients.

KS

Discharge of a Fiduciary under Code §2204

United States v. Paulson

2020 WL 1821022 (S.D. Ca.)

Whenever we assist our client fiduciaries with the filing of an estate tax return, part of the package prepared and filed with the Internal Revenue Service is the request made pursuant to §2204 for a discharge of the fiduciary from personal liability. There is no form specified for making this request, particularly when the estate tax return is filed by the trustee of the decedent's revocable trust as the statutory executor.

In *Paulson* the government argued that the defendant had not been discharged from personal liability pursuant to §2204 for the payment of estate tax that had been assessed against the estate. The government argued that Paulson did not request discharge from personal liability as trustee. Paulson's request was entitled "Co-Executor's Request for Discharge from Personal Liability Pursuant to I.R.C. Section 2204" and did not specifically mention his role as trustee of the decedent's revocable trust. The court disagreed with the government, noting that Paulson filed the estate tax return as a statutory co-executor as co-trustee of the decedent's trust (no executor of a probate estate had been appointed). The court noted that §2204 applies to the statutory executor as well as to a court appointed executor, and only requires that the application for discharge be made in writing. It is then the obligation of the government to contact the executor who requested discharge to notify the executor (within nine months after making application for discharge) of the amount of the tax. Although the government acknowledged receipt of the letter, it never contacted Paulson regarding his request for discharge as fiduciary, even though the estate tax remained unpaid. At a minimum, the government had the obligation to notify Paulson that he may be personally liable and not wait for 12 years to seek to impose personal liability, claiming that the application for discharge was ineffective for Paulson in his role as trustee.

In any event, §2204 involves the discharge from personal liability of the court appointed executor and of the statutory executor whose obligation was to file the estate tax return for the estate tax assessed against the estate. Code §6324(a) imposes continuing personal liability for estate tax of a person in possession of the decedent's property at the time of death, whether as a trustee or as a transferee, or in some other capacity. 31 U.S.C. §3713 imposes personal liability on a fiduciary for violating the government's priority for payment of its tax. A request for discharge of personal liability pursuant to §2204 does not apply to discharge personal liability arising under §6324(a), or under 31 U.S.C. §3713.

KS

Penalty for Late Filing

Estate of Skeba v. United States

2020 WL 70962 (D. N.J.)

The facts in *Skeba* and *Estate of Young v. United States*, 2012-2 U.S. Tax Cas. (CCH) ¶60,658 (D. Mass. 2012), are essentially the same. Yet the result in *Skeba* is taxpayer favorable and in *Young* the court acknowledged that "[t]he late-filing penalty that the Estate faces here may seem unfair" but the taxpayer nevertheless was assessed the penalty that *Skeba* held should not apply.

In each case the situation was late filing of an estate tax return, later than the date each estate had obtained as an extension of the time to file that return. In each case the estates also obtained extensions of the time to pay the estate tax, and in each case the estates paid more than the tax ultimately due, and they did so before the due date as extended. Thus, is *Skeba*, the taxpayer died June 10, the initial date to file was the following March 10, a timely extension was requested and granted to file by September 10. The time for payment also was March 10, which also was extended to September 10, and an overpayment of over $940,000 was made on March 18 – just 8 days after the original (unextended) date for payment and nearly five months prior to the extended payment date. Because the actual filing was late, however, the government asserted that the fact that the payment was timely was insufficient to avoid the penalty for late filing.

In each case the issue of a penalty was due to late filing – beyond the extended due date – and was being sought by the government as informed by the total tax liability, not any underpayment of tax. The penalty was being asserted notwithstanding representations that were given to the estate's personal representative by government personnel that filing an estate tax return late will result in *no* penalty if the tax due was fully paid before the date prescribed for payment. Told that, "if you're paid in, you're fine," the Skeba estate delayed filing the return for over nine months past an extended filing deadline. The government sought to impose a nearly $451,000 penalty for late filing. Even though there was no underpayment – each estate was entitled to a refund of the overpaid amounts – which the government sought to reduce by the penalties assessed for late filing. And in each case the government's assertion of a penalty for late filing was based on the original amount due on the date for payment, without regard to the extension that was granted, and that the estates met.

The government's assertion of the penalty was based on what the *Skeba* court regarded as a "clever" but flawed argument, denying the timely-filing penalty because the estate overpaid its tax before the extended due date for payment. In these cases the government reads the §6651(a)(2) requirement to pay "on or before the date prescribed for payment of such tax (determined with regard to any extension of time for payment)" as informed by §6151(c), reading "any reference in this title to the date fixed for payment of . . . tax shall be deemed a reference to the last day fixed for such payment (determined without regard to any extension of time for paying the tax)." The *Skeba* opinion regarded the extended due date to be controlling, not the date without regard to extensions, because §6651 is the specific provision and §6151 is "a more generic statute" (which nevertheless purports to apply to "any reference in this title" – meaning the entire Internal Revenue Code). As such, the penalty under §6651(a)(1) for late filing should be a percentage of the "amount shown as tax" as reduced by the payments made within the extended due date for payment. The court thus rejected the government's argument that the penalty should be assessed based on only the tax paid before the original due date, without regard to any extension.

In each case the estates' advisors were informed (in *Skeba*, by government representatives, and in *Young*, by the accountants on whom the taxpayer relied) by individuals who all misunderstood the late filing penalty rules. All advised that there would be no penalty for late filing, because the estate had paid more than its eventual tax liability. According to the court in *Young*, this advice would have been correct if the taxes had been paid before the original payment due date. But the bulk of the payments in each case were made after the original due date but before the extended due date. Which *Young* held was not adequate to prevent the penalty for late filing. As acknowledged by that court, "if the Estate had paid its estimated tax liability before the original payment deadline – as opposed to before the extended payment deadline – there would be no late-filing penalty."

As a cherry on the top of the taxpayer-favorable conclusion, the *Skeba* court also found that penalties were not proper because the taxpayer showed that its failure to file on time was "due to reasonable cause and not due to willful neglect." That afterthought was dicta, presumably offered to preclude reversal if the government appeals the §6651 conclusion. It is not, however, precedent on which a prudent fiduciary would rely.

The Code provisions, and the results reached, are confusing. As are the conflicting results in *Skeba* and in *Young*. As such, the better advice appears to be that, notwithstanding being paid "all in," filing is best done on time. Especially because litigation of such a question is far more onerous than asking for extensions of the time to file (which are not as difficult for the government to approve if the tax already has been fully paid). In addition, whenever possible, taxpayers should regard the need to pay an estimate within nine months of the decedent's death – regardless of when its return is due – as the safest approach.

JP

What Is the Value of an Assignee Interest?

Estate of Streightoff v. Commissioner

954 F.3d 713 (5th Cir. 2019)

The Tax Court, and more recently the Court of Appeals for the Fifth Circuit, has again faced the question – if I transfer an interest in my closely held entity, what is the character of the interest that the recipient receives? The answer governs valuation of and, ultimately, the tax on the interest transferred by the donor (or decedent, as the case may be).

In *Streightoff* the Court of Appeals for the Fifth Circuit affirmed the Tax Court's determination that a decedent's transfer of his partnership interest to his revocable trust constituted a transfer of a partnership interest, *not* a transfer of an assignee interest.

Although the governing entity agreement permitted a transfer from a partner to a trust for the partner's benefit, the agreement required several steps to admit the transferee as a partner, including the General Partner's approval of the assignee's admission. And, although the General Partner signed several documents involved in the transaction, the General Partner appears not to have formally approved the revocable trust's admission to the entity.

The Tax Court applied substance over form, allowing the court to look beyond the formalities to the substance of the transaction. Because the Tax Court saw the decedent and his revocable trust as substantively identical, the fact that the revocable trust was not formally admitted by the General Partner was not dispositive. The Tax Court found, and the Court of Appeals affirmed, that the entity interest was assigned to a permissible assignee, the transfer was a permissible transfer under the entity agreement, the revocable trust agreed to be bound by the entity's governing agreement, and the document assigning the interests from the decedent to the trust was signed in several places by a representative of the General Partner – thus implying the General Partner's consent to the revocable trust's admission to the Partnership.

In further support of its conclusion, the appellate court's opinion pointed to the Tax Court's determination that, even if the revocable trust were not a substitute limited partner, there was no practical difference between the decedent as an 89% limited partner and the revocable trust as an 89% unadmitted assignee. This was because, in essence, the limited partners of the Partnership did not invoke any of the rights that made them different from unadmitted assignees – the Partnership never held votes and no partner ever requested to look at the books and records of the Partnership. The appellate court even suggested that a hypothetical purchaser might pay a *premium* for an interest that would allow the owner to terminate the entire Partnership.

This author hopes that this last discussion in the case is determined to be dicta. Otherwise, this troubling conclusion by an appellate court that is regularly perceived to be "taxpayer-friendly" may lead to deterioration of the same hypothetical willing buyer/willing seller rule that was just reaffirmed by the Tax Court in the *Grieve* case (reported next below), when Judge Kerrigan wrote, "We do not engage in imaginary scenarios as to who a purchaser might be."

SLP

Valuation 101: The *Hypothetical* Willing Buyer/Seller Test

Grieve v. Commissioner

T.C. Memo 2020-28

The Tax Court opinion in *Grieve* touched on several hot button issues – including hot tubbing, tiered discounts, and tax effecting. But, ultimately, the case revolved around, and was decided on, valuation principles, with special focus on that most fundamental rule – fair market value is the price at which the asset would trade hands (though not in a fire sale) between a hypothetical willing buyer and hypothetical willing seller, both with knowledge of all relevant facts.

Although the case touches on several issues, perhaps the most important holding is the court's rejection of a valuation approach increasingly embraced by at least one judge on the Tax Court – that the owner of a small controlling interest in a partnership or LLC should be presumed to be bought out by the recipient of the larger, non-controlling interest (typically, the gifted interest), and that the presumed buy-out should be taken into account for valuation purposes (thereby reducing or depleting altogether discounts for lack of marketability and lack of control that otherwise would apply). In a clear statement to the contrary, Judge Kerrigan opined: "We [the United States Tax Court] do not engage in imaginary scenarios as to who a purchaser might be."

In this case, Mr. Grieve gave a 99.8% non-voting interest in two entities to a Grantor Retained Annuity Trust (GRAT), reporting the gifts with a fair market value that reflected a combined 35% discount for lack of control and lack of marketability. At trial, the government argued that fair market value should be determined based on the *assumption* that the hypothetical purchaser of the 99.8% interest would either have or could/would obtain the remaining 0.2% voting interest and, as a result, would own 100% of the entity. Consequently, the government argued, a combined discount of no more than 1.4% should be allowed.

The Tax Court rejected the government's approach, explaining: "When a gift of property is made, its value at the date of the gift shall be considered the amount of the gift. . . . The facts do not show that it is reasonably probable that a willing seller or a willing buyer of the Class B units would also buy the Class A units *and* that the Class A units would be available to purchase." (emphasis added).

Judge Kerrigan's conclusion bears repeating. "We do not engage in imaginary scenarios as to who a purchaser might be." This win for the taxpayer specifically is a win for taxpayers generally – in no uncertain terms refuting the increasingly frequent supposition in Tax Court jurisprudence that such an imaginary scenario should be posited and relied upon for valuation purposes. After nearly a decade of hints and suppositions in Tax Court holdings, the *Grieve* opinion at least has put this burgeoning theory to rest.

SLP

Must Trustee Consider Beneficiary's Other Resources?

In re Raggio Family Trust

2020 WL 1846524 (Nev. 2020)

There is significant uncertainty in American trust law regarding the question addressed by *In re Potter Exempt Trust*, 593 S.W.3d 556 (Mo. Ct. App. 2019). The trust was created in 1988 by

John's grandmother and was exempt for generation-skipping transfer tax purposes. It provided a life estate for John's father and, after his death, for John's life, with remainder to his descendants. The applicable distribution provision during John's tenure directed that "[t]he Trustees shall use and apply so much of the net income of [the trust] as they may deem necessary or advisable to or for [John's] benefit."

For nearly four years after his father died no distributions were made to John. However, in 2012, John requested that the trustees distribute income "to provide cash flow for his real estate business." The corporate trustee distributed over $211,000 over the next 21 months pursuant to that request. The lower court confirms that this was all of the trust's net income earned during that period. There is no indication whether income taxes might have been a factor under consideration but an attorney knowledgeable about the case indicates that John was subject to both state and federal income tax, that his marginal rate might have been the same as the trust, and that the trust was not subject to state income tax. So accumulations of income inside that trust might have been taxed at a lower rate than income distributed to John. As a result, it appears that the decision to flush income out of the trust was not tax-motivated.

An individual cotrustee – the attorney who drafted the trust and represented the settlor – objected to these income distributions, insisting that John must first provide financial information to the trustees. The individual cotrustee asserted that the trustees must consider that data before making the income distributions. John was loathe to reveal that information, and the corporate cotrustee did not agree with the individual trustee (their differences ultimately led to removal of the individual trustee). So the corporate trustee petitioned the court for instructions on the issue. The lower court concluded that "[t]he Trustees have the authority, at their discretion, to distribute the net income of the . . . Trust to John . . . for his ongoing support and benefit without consideration of [John's] personal income or financial resources and that the Trust Agreement does not require [John] to exhaust all of his available financial resources before the Trustees make any distribution of net income to him." Accordingly, the lower court ruled that the individual cotrustee's demand for financial information before any distributions could be made to John was inappropriate.

The lower court's holding regarding other resources was reversed on appeal, which frames the legal question: must a trustee of a discretionary trust consider other resources of the current beneficiary when exercising discretion to make distributions to that beneficiary? According to this opinion, "Grantor intended that the trustees have discretion regarding distribution of income, and that discretion includes requesting [John's] financial information before authorizing income distributions."

One notable element of the trust itself was that, during the life estate of John's father, and during the minority of any other beneficiary, the applicable income distribution provisions authorized the use of trust income as the trustees "deem necessary or advisable primarily for the proper health, education, maintenance, and support" of the current beneficiary. That classic "ascertainable" standard was missing from the provision authorizing distributions of "net income" to John after his father's death. Also curious was that the authority permitting distributions of principal to any income beneficiary was four pages removed from the income distribution provisions, it was exercisable by the corporate trustee alone, and it was limited to amounts needed for "emergencies" only.

Further unusual about these distribution provisions was that the clause applicable when John's father was beneficiary contained a sentence calling for undistributed income to be added to principal, annually. That clause was not included in the provision calling for income distributions to John. Did that indicate that all income would be distributed to John, meaning that the trustee need not exercise discretion (and, thus, also need not consider John's other resources)? The court provided no explanation for these differences.

In analyzing the fundamental question, the court first characterized this as a "need" trust, based on the terms "necessary or advisable" used in the standard for income distributions to John. Based thereon, the court cited authority that, under Missouri law, "where [a] gift includes a provision for distribution based on need, the trustees must consider the beneficiary's income in determining the beneficiary's need." On the other hand, under Missouri law, the trustee would not consider the beneficiary's other resources if the trust called for the trustee to "support" the beneficiary, regardless of need. But "support" was not the standard that applied to John, Meaning, the appellate court concluded, that this "need" trust required "the trustees . . . to exercise their discretion in determining what is necessary or advisable" and, with that discretion, then were faced with the question of what factors to consider. That raised the issue of whether to inquire about and consider John's other resources. Somewhat inconsistently, the court ultimately stated that "the trustees have authority to examine [John's] other financial resources in making their decision regarding what is 'necessary and advisable'. . . [but] the broad discretion granted to the trustees does not require them to do so."

The court relied heavily on Restatement (Third) of Trusts §50, Comment *e*. This is notable because the Reporter's Note to Comment *e* candidly admits that "[t]his Comment adopts a position different from that stated in prior Trusts Restatements." The Comment justifies that modification by noting that "cases, frequently even within a given jurisdiction, are in conflict." Stated differently, both the Restatement (Third) and *Potter* deviate from the traditional rule, under which a beneficiary's other resources are *not* to be considered when a trustee exercises its discretion in a case such as this. This is especially troubling in *Potter* because the Restatement (Third) is dated 2003, fifteen years after the Potter trust was created, meaning that the presumption when the trust was created was different from what it was held to be in this litigation. The court does not address that retroactive application of this changed presumption.

Pulling back from the specifics of the Potter trust, the Restatement (Third) states that it is easier to decide discretionary-distribution cases in which a trust was created for the "support or maintenance" of the beneficiary. Those two terms are regarded as synonymous, they create a presumption that need is a critical element, and that the beneficiary's other resources are an essential factor to determine need. Notably, however, John's trust was not created for his support or maintenance, and the Restatement's explanation is at odds with the Missouri rule that a support trust means that the trustee has no discretion and must make distributions regardless of the beneficiary's other resources. It is no wonder that the Restatement (Third) of Trusts also opines (see §60) that there should be no difference between a support trust and a discretionary trust – in part (it may be presumed) because the law on these matters is hopelessly confused.

The Restatement is prescient in also observing that cases tend to dwell on differences in language, such as (a) whether the trustee "must" or only "may" distribute income based on the needs of the beneficiary, (b) whether reference is made to the beneficiary's accustomed standard of living (a concept missing in *Potter*), and (c) the size of the trust ("when a trust fund is small, it is more likely to be required that other resources be taken into account"). Further, "for a purpose that falls within the reasonable discretion of the trustee but which the applicable standard would not require the trustee to furnish . . . the trustee has discretion to make a loan or advance to the beneficiary . . . at low or no interest . . . with recourse only against the beneficiary's interest, without personal liability." The Restatement thus suggests that an alternative to distribution of the net income to John in *Potter* would be to provide a cash flow for his real estate business via a loan (on favorable or market terms). That option is not mentioned in the opinion, either, although the lower court opinion indicates that John had borrowed from the corporate trustee's banking department and that his personal revocable trust was collateral for that loan.

Potter teaches at least three lessons. The first applies regardless of whether the Restatement accurately identifies a transition that is occurring in American trust law. A settlor cannot be too explicit in stating whether or how a beneficiary's other resources should be considered. For example, a settlor's decision whether the trustee should consider a beneficiary's other resources – or ability to earn – is difficult, given that reducing trust distributions based on a beneficiary's self-reliance or industry may discourage the beneficiary from being productive. Few settlors wish their largess to thwart a beneficiary's ambition. On the other hand, if funds are dear and the needs of multiple beneficiaries all must be considered, then providing benefits to a beneficiary regardless of need (because a beneficiary has other resources or opportunities) also makes little sense. And then there is the uncomfortable inquiry itself, if a trustee must demand financial information and try to assess whether a beneficiary is being a proactive and productive member of society. Should, for example, two children be treated differently if one chooses to join the Peace Corp and another is a titan of Wall Street?

Second, as candidly stated in the Restatement Comment on subsections (1) and (2) of §50:

> factors often cited in opinions as influential range from the particular language used in the grant of discretion (e.g., details of wording such as whether "may" or "shall" was used, whether discretion was about "necessary" rather than "appropriate" to a beneficiary's support, . . . whether the discretion is applicable to income as well as principal, whether the settlor made other provision for the discretionary beneficiary . . . whether the settlor was aware of the beneficiary's other resources or of other circumstances . . . . Realistically, however, these factors often reveal little of a settlor's actual intent. The settlor may have formed no intention on the matter at issue, or whatever intention may have existed might not have been ascertained by counsel or preserved in the drafting.

Divining settlor intent from factors such as word choice may be a necessary endeavor for trust interpretation or construction, but the ascription of intent may give too much credit in some cases to arbitrary drafting conventions, or choices made by the drafter without actual confirmation of the settlor's intent. Worse, several tell-tales in the Potter trust also suggest that the drafter was not particularly skilled at his craft, which may indicate that no one – neither settlor nor drafter – considered the particular issue that was central to this case or crafted provisions that accurately reflected the settlor's intent.

Third, as a practical matter, formulating a one-size-fits-all approach in any given trust may be nearly impossible, particularly in long term trusts that benefit multiple generations of beneficiaries (perhaps for as long as the Rule Against Perpetuities may permit, which might be centuries, or longer). Which speaks in favor of giving a trustee maximum flexibility in making the decision whether to consider other resources and abilities. Giving maximum flexibility means that selection of the fiduciary is a critically important – and difficult – function in planning long-term trusts. Reliance on the good judgment of a trustee, who may be selected as a successor many years in the future, is a daunting challenge. Which comes back to providing a guide to the settlor's overarching perspective on such questions as "need" and how to judge whether a beneficiary has other available resources and is being productive.

It is a rare settlor who doesn't have an opinion about whether beneficiaries should maximize their potential, versus living life as a silver-spoon trust-fed baby. And how a trustee is to determine whether beneficiaries in fact are maximizing their potential. The Restatement applies a presumption that may reflect modern attitudes, but it has met with some resistance from drafters who embrace traditional rules. Worse, as in *Potter*, the Restatement may be applied to trusts drafted years ago, when expectations (informed by prior presumptions) were different.

In relatively stark contrast to *Potter* and the Restatement is *Raggio*, in which the same question about consideration of a beneficiary's other resources was decided directly contrary to the Restatement position. In part based on Nevada Revised Statute §163.4175, which expressly provides: "Except as otherwise provided in the trust instrument, the trustee is not required to consider a beneficiary's assets or resources in determining whether to make a distribution of trust assets." Enacted in 2009, there is no indication that it was in response to the Restatement, and application in *Raggio* was sufficiently different as to highlight the significance in less stark circumstances.

The *Raggio* trust divided at the settlor's death into marital deduction and credit shelter portions, both held for the benefit of the settlor's surviving wife, and she was trustee of both. Odd about them was that the marital trust remainder beneficiaries were the settlor's daughters from a prior marriage but the remainder beneficiaries of the credit shelter trust were grandchildren of the surviving spouse from a prior marriage. The controversy could have been avoided had both trusts passed to these respective beneficiaries in predetermined percentages, rather than all of one trust passing to one group and all of the other passing to the other. Because the challenge brought by the settlor's daughters was that the surviving spouse, as trustee, was making distributions to herself from the marital trust without consideration of her interest in the credit shelter trust. The net effect of which was to preserve the remainder that would pass to her grandchildren and reduce the remainder passing to her step-daughters. The court rejected the suggestion that invasions of the marital trust should be made only after consideration of the trustee-beneficiary's interest in the credit shelter trust.

Decided only in part based on the Nevada statute, the other determinant was a provision elsewhere in the trust document allowing discretionary distributions to other beneficiaries based on an ascertainable standard "after taking into consideration . . . any other income or resources" of those beneficiaries. That quoted language was not included in the trustee's discretionary distribution provision for herself. The court correctly surmised that the difference in language should be considered, and as intentional. The drafting lesson is that the *Raggio* litigation might have been avoided had the provision for the widow stated expressly that distributions in the trustee's discretion would be proper "without considering other income or resources" (the opposite of what was stated for those other beneficiaries).

Both cases underscore that giving more guidance in drafting a trust is critical, because drafters today don't know how the rules may morph during the term of a trust. Which returns this discussion to the first point: statements revealing settlor intent are essential. The trust in *Potter* gave more direction for distributions of income during the life estate of John's father than it did thereafter. Quaere why. And (in this respect) did the drafter err? The trust in *Raggio* addressed the other resources issue with respect to one set of beneficiaries, but not the surviving spouse. Quaere why not. In each case, in this respect, did the drafters err?

JP

Agent's Power to Make Gifts

Davis v. Davis

835 S.E.2d 888 (Va. 2019)

A frequent question arising under durable powers of attorney is whether the agent holding the power has authority to make gratuitous transfers on behalf of the principal (or otherwise to alter the principal's estate plan). A consistent concern is whether the powerholder breaches any fiduciary duty by reducing the principal's estate. Alternatively, the powerholder might properly serve the principal's best interests by, for example, making transfers that may reduce state or federal wealth transfer or income taxes.

Tax minimization was not an alleged justification for the transfers in *Davis*. And the court did not elaborate on the family dynamic involved, including that the powerholder was the principal's parent, although the gifts were made to the powerholder personally, as well as to the principal's two siblings. The challenge was brought by the principal's surviving spouse, who married the principal just six weeks prior to the principal's death "in a closed-door ceremony conducted in [the principal's] room" in a nursing center, to which the principal had been transferred, over 100 miles from his home. The court does not say that this marriage was opposed by the powerholder as parent of the principal, nor does the court opine on whether the marriage was appropriate or an overreach under the circumstances.

Instead, the court simply analyzed the terms of the power and concluded that none of its provisions authorized end-of-life gifting. The express language of the power included several common authorizations: that the powerholder could (1) "transact . . . all business . . . that [the principal] could do"; (2) "sell and convey any and all personal property and all real property" belonging to the principal; and (3) "execute and perform all and every act . . . to all intents and purposes whatsoever as [the principal] could do if acting personally." None was deemed to authorize the transfers, the impact of which (if effective) would have virtually exhausted the principal's estate.

The court did note that "a transaction with the principal's assets to the benefit of the attorney-in-fact" is "presumptively fraudulent." Meaning that the burden of persuasion was on the powerholder to produce clear and convincing evidence that the transaction was authorized. Damning to the powerholder's case was that (1) the powerholder was one of several recipients of the transfers that were made, (2) the powerholder transferred "the vast majority" of the principal's personal property and all of the principal's realty, and (3) the powerholder did not inform the principal that these transfers were made. Moreover, (4) the principal did not have a history of making large gifts, nor was there evidence of gifting to the individuals who the powerholder benefited.

According to the court, limited precedent exists regarding the "sell and convey" language, and what there is stands for the proposition that this "legal doublet" contemplates transfers for consideration, not gratuitous transfers. In addition, the "sell *and* convey language" cannot be read as if it was instead "sell *or* convey," which would alter its obvious meaning. Further, a state statutory authority to make gifts limited to the gift tax annual exclusion amount could not be used to justify the transfers in question, which totaled over $2 million.

In sum, as articulated by the court, significant express authority is required to justify substantial gifts of a principal's wealth, along with compelling justification or a history of giving that the powerholder is continuing. Drafters who intend to empower an agent to make gifts should be direct and express in the authority granted, and likely should be expansive in describing the nature and extent of the gifting that is meant to be allowed.

JP

Specific Reference Requirement

Estate of Eimers v. Eimers

2020 WL 2519594 (Cal. Ct. App.)

A well-drafted power of appointment will specify how it may be exercised, normally requiring "an express reference to the power of appointment to . . . preclude the use of form wills with 'blanket' clauses exercising all powers of appointment" available to the testator. Quoting the Law Revision Commission Comment on Cal. Prob. Code §632, which was one of three sections implicated in *Eimers*, in which the trustee of a trust granting a power of appointment conceded that the powerholder intended to exercise that power. Nevertheless, the trustee successfully denied effective exercise because the powerholder made a specific reference to the *trust* granting the power, but not to the *power* itself. If that technicality doesn't make sense, consider the following factors:

> First, the provision granting the power itself specified: "any share held in trust for the child's benefit . . . shall be distributed . . . as said child may provide and appoint by will *specifically referring to* and exercising *this power* of appointment" [emphasis added].
>
> Second, the provision seeking to exercise the power stated: "I hereby leave my shares of the [properly identified] Family Trust."

In light of the powerholder's reference to the trust and not to the power, also consider California Probate Code §§630, 631(b), and 632. The first specifies that a power that imposes requirements for exercise of a power to appoint "can be exercised only by complying with those requirements." The last provides: "If the creating instrument expressly directs that a power of appointment be exercised by an instrument that makes a specific reference to the power or to the instrument that created the power, the power can be exercised only by an instrument containing the required reference." Finally, §631(a) allows a court to "excuse compliance" with the terms of a power and declare than an exercise of the power is effective if "(1) the appointment approximates the manner of appointment prescribed by the donor; and (2) the failure to satisfy the formal requirements does not defeat the accomplishment of a significant purpose of the donor." But then §631(b) specifically states that §632(a) "does not permit a court to excuse compliance with a specific reference requirement."

Thus, by statute, California allows specific reference requirements, it "actually distinguishes between a specific reference to the power of appointment itself and a specific reference to the instrument," and it negates a "harmless-error" or "substantial compliance" approach to satisfaction of those requirements. Meaning that California takes specific reference requirements *very* seriously, to preclude the inadvertent or not-sufficiently-thoughtful exercise of powers that may fail to consider the tax consequences or an inadvertent exercise in favor of unintended beneficiaries.

Not many states are this explicit or demanding regarding the exercise of powers to appoint. Nevertheless, experienced planners appreciate that prevention of inadvertent (or even "silent") exercise normally is wise, particularly in the ever-changing federal wealth transfer tax environment in which it may be good to exercise powers (to generate a new basis for assets included in the powerholder's estate) or bad (because exercise can generate unwanted state or federal transfer tax liability), in addition to unexpected Rule Against Perpetuities violation, improper appointment to invalid appointees, or (worse) exposure to creditors of the powerholder. All of which is possible (although perhaps unlikely) depending on the age of the trust granting the power, the breadth of the permissible appointees, state law (and whether that is the law of the powerholder's domicile or that governing administration of the trust granting the power), and the current state of the tax laws. Careful evaluation of these factors is essential with regard to powers, making California's careful approach appropriate and something to emulate everywhere.

JP

First, Determine if a No-Contest Provision Will Apply

Hunter v. Hunter

838 S.E.2d 721 (Va. 2020)

The logic, and articulation of the underlying issue, in *Hunter* is so well-written that they demand no interpretation. Rather: everything that follows what the court (Justice Kelsey) wrote:

> Charles and Theresa . . . had two children, Charles ("Chip") and Eleanor . . . . Charles and Theresa created separate revocable living trusts . . . . Both trusts named Chip [and] Eleanor . . . as contingent beneficiaries. . . . The Theresa Trust named Theresa and Eleanor as initial co-trustees, and if Theresa ever became unable or unwilling to serve as trustee, Eleanor would be the sole trustee.
>
> After Theresa died . . . Chip received a brokerage account statement from his sister that allegedly showed a decline in the value of trust assets from $4.25 million to $1.77 million over the course of less than 6 years, which was during a period in which stock values had steadily risen across most market sectors. Chip requested additional information from his sister, including a full financial report of trust property that detailed receipts, disbursements, liabilities, trustee compensation, and asset valuations. According to Chip, Eleanor's counsel refused to provide the additional information in reliance on a trust provision stating that the settlor "waive[d] the Trustee's formal requirements to inform and report . . . ."
>
> Chip filed this declaratory judgment action, seeking a favorable interpretation of the trust that would require Eleanor to provide Chip with information and documents related to the trust. Aware of the no-contest provision in the Theresa Trust, Chip divided his declaratory judgment complaint into two carefully worded counts. Count II acknowledged the ultimate goal of the litigation by asserting that Chip sought the "determination of the rights of Chip and Eleanor" under the terms of the Theresa Trust to require the trustee to inform and report . . . .
>
> The complaint expressly sought to create a firewall protecting Count I from any uninvited, premature consideration of Count II. . . . Count I requested that the circuit court "initially determine" whether determining Chip's and Eleanor's rights and duties under the trust "would constitute a 'contest'" under the no-contest provision . . . . Count I stated that the court should consider the request in Count II "if, and only if," the court interpreted the no-contest provision to be inapplicable. . . .
>
> > As a general principle, one who seeks the guidance of a court in interpreting a provision in a will is not considered to have "contested" the will in a manner which

would actuate a forfeiture clause. While forfeiture clauses or “no contest” clauses effectuate the testator’s legitimate interest in preventing attempts to thwart his intent, a request for interpretation does not challenge the intent of the testator or the validity of the will.

Count I of Chip’s complaint . . . did not seek to “contest” the Theresa Trust or any of its provisions but rather sought only “an interpretation of the trustee’s inform and report requirements” under the specific “language” of the trust and under any independent duties of this kind . . . .

The circuit court held that Count II of the complaint had triggered the no-contest provision and, on this basis, ordered the forfeiture of Chip’s interest in the Theresa Trust. Even if it were true that Count II had violated the no-contest provision, the court erred by disregarding the if-and-only-if proviso of Count I and ordering a forfeiture based upon Count II. Instead, in such a scenario, the circuit court should have entered judgment on Count I in Eleanor’s favor and dismissed Count II as moot.

. . .

Construing a legal document and contesting it are two different things. . . . A successful construction of an instrument can, and usually does, eliminate any need to contest it. . . .

. . . [S]eeking the “guidance of a court in interpreting” a disputed provision of a will does not constitute contesting the will “in a manner which would actuate a forfeiture clause.” . . . The same is true in trust law. . . . “The primary justification for distinguishing this type of action is that it involves beneficiaries who are seeking to clarify what the testator actually meant and therefore to implement, rather than impede, the testator’s intent.” . . .

. . . [A] trust’s very identity as a creature of equity presupposes the possibility of oversight of the trustee by a chancellor jealous of safeguarding the rights of all parties with an interest in the trust.

. . . [T]he declaratory judgment action did not trigger the no-contest provision in the Theresa Trust requiring the forfeiture of Chip’s interest in the trust. For this reason, we reverse the circuit court’s summary judgment dismissing Chip’s complaint and remand the case . . . .

[Footnote 5] . . . Given our narrow holding, we leave for future consideration how, if at all, these observations affect the ultimate scope of no-contest provisions in trust instruments that seek to shelter fiduciary misfeasance or malfeasance.

JP

CARES Act Implications for Charitable Giving During COVID-19

The save-the-economy CARES Act passed by Congress and signed by the President on March 27 includes a wide variety of provisions designed to rescue an economy brought to its knees by the coronavirus pandemic. Recognizing that charitable giving to a myriad of organizations will suffer in the current economic environment at a time when charitable support of so many activities is of critical importance, the Act includes several provisions to encourage charitable giving.

Above the line charitable deduction

Section 2204 of the Act amends the Internal Revenue Code by adding new § 62(a)(22), allowing taxpayers who do not itemize deductions to deduct up to $300 for certain charitable gifts made in 2020. The Joint Committee on Taxation explanation of the Act states that the deduction is limited to $300 for couples filing a join return even if each spouse makes a $300 contribution. The contribution must be made in cash to a public charity other than a supporting organization or donor advised fund. Only contributions actually made in 2020 qualify, so excess cash contributions carried over from a prior year and treated as made in 2020 are not eligible. Although the amount is small, it is better than nothing—especially because so few people itemize (now that the deduction for state and local taxes is limited to $10,000). Even better would be a permanent charitable deduction for nonitemizers subject to the same percentage limitations that apply to taxpayers who itemize deductions.

Suspension and relaxation of percentage limitations for cash gifts

The other and more important provision to encourage charitable giving is made by Act section 2205, which eliminates the Code §170 percentage limitations on most cash gifts to public charities. Under the law in effect prior to this change, contributions of cash to a public charity were limited to 60% of adjusted gross income. (Because of a drafting error in the 2018 tax legislation, it appears that the 60% percentage limitation is only allowable to taxpayers making no noncash contributions in the same year. It was expected this would be fixed in technical corrections but that has not yet happened. As drafted this is not an issue with the new 100% cash deduction limit.) As with the $300 "above-the-line" deduction discussed above, the suspension of percentage limitations for cash contributions does not apply to gifts to supporting organizations or donor advised funds. Finally, if a contribution exceeds a donor's adjusted gross income, the excess can be carried over to subsequent years, but subject to the percentage limitations in the carryover years.

A similar change was made to charitable contributions by corporations. Under the law prior to 2020, charitable contributions made by a corporation could not exceed 10% of taxable income (with certain adjustments). This has been increased to 25% by the Act for cash contributions made in 2020.

With respect to both individual and corporate cash contributions, the increased deduction is not automatic, but must be elected. Undoubtedly there will be further guidance from the Internal Revenue Service when the time comes to file 2020 tax returns.

Planning strategies with suspension of percentage limitations for cash gifts by individuals

What strategies should donors consider, given the temporary elimination of percentage limitations for certain cash contributions? Gifts of securities are not "qualified charitable contributions." A donor with securities that have declined in value below cost may wish to sell those securities, realize the capital loss, and contribute the cash without regard to percentage limitations. Or the capital loss may be used to offset gain on the sale of appreciated assets, again generating cash that can be used for charitable contributions without percentage limitations. Even if a donor recognizes capital gain, donating the sale proceeds could eliminate taxation of any ordinary income, leaving only capital gains to be taxed. It appears that a taxpayer can actually eliminate any taxable income tax this year by making sufficiently large cash charitable contributions.

One final charitable change in the Act increases the limits on contributions in 2020 of certain food inventory under Code §170(e)(3)(C) from 15% to 25%.

Charitable implications of suspension of qualified plan required minimum distributions

The CARES Act also made several changes to retirement plan distributions, which may affect charitable giving. Section 2203 of the Act suspends required minimum distributions (RMDs) from most qualified retirement plans, including IRAs. This could reduce the incentive to make charitable distributions from IRAs in 2020. (The IRA charitable rollover remains available in 2020.) For example, the best strategy for a taxpayer with an RMD of $100,000 who usually makes $50,000 in IRA charitable rollover gifts each December may be to make no IRA charitable gift in 2020 and make $50,000 rollover gifts in January and December 2021.

On the other hand, because of the unlimited charitable deduction allowed for cash gifts to charity in 2020, a taxpayer can, in effect, make a tax free rollover of any amount to charity in 2020 by making a taxable withdrawal from an IRA that will be included in income, giving the cash to a public charity, and offsetting the income completely by the charitable deduction, regardless of the amount. This may present real opportunities for charities and donors. For all years other than 2020, the only way to transfer a large IRA to charity without tax was at death, by beneficiary designation. But in 2020 the IRA can sell its assets and distribute the cash proceeds to the IRA holder, who can then give them to charity and deduct them in any amount without regard to percentage limitations. It might have been even simpler if Congress had simply suspended the $100,000 limitation on IRA charitable rollovers for 2020.

LK

CARES Act Waiver of 2020 Required Minimum Distributions

The Coronavirus Aid, Relief, and Economic Security ("CARES") Act was signed into law on March 27, 2020. It contains certain relief provisions for retirement accounts.

CARES Act §2203(a) will affect many individuals. This provision added a new Code §401(a)(9)(I), which waives all required minimum distributions ("RMDs") for 2020. This is similar to what was done in 2009. Congress acted then and now with the intention of helping account owners who saw a dramatic drop in the value of their investments in their retirement accounts.

An RMD is the amount of money that must be withdrawn by the account owner of a traditional IRA when the account owner reaches a certain age and by the beneficiary of an inherited IRA. The CARES Act waives RMDs for 2020. Although some relief under the CARES Act applies only to those impacted by COVID-19, such as the ability to withdraw up to $100,000 without penalty, this waiver of RMDs for 2020 is not limited to those who are affected by COVID-19. This waiver of RMDs applies to (1) any account owner who is 72 or older in 2020, (2) any account owner who turned 70½ in 2019 who did not take her RMD for 2019 and planned to take her delayed RMDs by her required beginning date of April 1, 2020, and (3) all beneficiaries of inherited IRAs for decedents who died prior to 2020.

New §401(a)(9)(I)(iii)(II) applies if the five year rule applies because a decedent died prior to 2020 before reaching his required beginning date without a designated beneficiary. In that case the five year period does not include 2020. For example, if such a decedent died in 2018, the decedent's entire interest in the account would have been required to be distributed no later than December 31 of 2023, the year containing the five year anniversary of the decedent's death. The date when the decedent's entire interest in the account must be distributed is moved to December 31 of 2024.

Because the CARES Act became law the end of March, there are those who have already taken RMDs prior to the enactment of the CARES Act, who are wonder whether they can put the money withdrawn back into their account. Any withdrawal from an individual's IRA in 2020 is no longer deemed to be an RMD because of the RMD waiver in the CARES Act. Any individual who has already taken a withdrawal in 2020 to satisfy what would have been the RMD may now transfer what was withdrawn back into the IRA within a 60 day rollover period of taking the withdrawal. If more than 60 days has elapsed since the withdrawal was taken, this rollover cannot be made without a waiver from the government of the 60 day rollover period. If an individual received a distribution early in the year, the 60 day waiver period elapsed prior to the enactment of the CARES Act. The only option at this time is to seek such a waiver.

Meanwhile, the government provided a general waiver of due dates in Notice 2020-23, which grants broad relief from due dates falling between April 1, 2020, and July 15, 2020. Anyone who took an RMD after February 1, 2020, now has until July 15, 2020, to return the funds to their account. The government may provide broader relief when it issues its guidance on the CARES Act later this year. However, any such relief will not help a beneficiary of an inherited IRA. Any beneficiary of an inherited IRA who withdrew her RMD prior to learning about the waiver of the 2020 RMDs may not return funds to the inherited IRA.

Because of the 2020 waiver of RMDs, there are now additional opportunities for tax planning with the amounts that, but for the 2020 waiver of RMDs, would have had to be withdrawn as RMDs. One possible tax strategy is to convert the traditional IRA to a Roth IRA in the amount of the RMDs for 2020 that no longer need to be taken in 2020 due to the 2020 RMD waiver. The individual will be able to move some funds to a tax-exempt environment while maintaining his or her anticipated level of taxable income.

KS

Attorney-Client Privilege: Nevada Has No Fiduciary Exception

Canarelli v. Eighth Judicial Dist. Court of Nev.

2020 WL 2777371 (Nev.)

Canarelli is a case of first impression, in which the Nevada Supreme Court addressed a trustee's petition for writ of prohibition (similar to a mandamus action in other states), challenging a district court order compelling the production of documents in a trust matter. The court granted the writ, correcting a lower court's order compelling disclosure of privileged information.

The Nevada court expressly declined to recognize the fiduciary exception to the attorney-client privilege where the trustee and the trust's beneficiary were adverse. The beneficiary sought to view communications between the trustee and the trustee's lawyer. The court overturned the trial court's determination that the trustee should produce that privileged material to the beneficiary. In almost these few words, the court held that a Nevada statutory provision "expressly lists five exceptions to the attorney-client privilege, none of which are [sic] the fiduciary exception." And then, the Nevada Supreme Court concluded, "we decline to create a sixth by judicial fiat."

Query whether the outcome would have differed if the beneficiary had sought production of materials communicating to the trustee's lawyer information regarding day-to-day administration of the trust, rather than materials shared with the trustee's lawyer regarding a dispute with the beneficiary. This distinction is one that several states have made in the past few years. For now, Nevada specifically does *not* recognize either type of fiduciary exception and, in this writer's view, likely will not, absent legislative action.

SLP

Unusual Grantor Trust Issue

Private Letter Ruling 202022002

When does a trust become a grantor trust with respect to a sale transaction, if the sale transaction is the trigger causing grantor trust treatment? This is the chicken-and-egg question addressed in PLR 202022002.

The facts were unusual. One trust (not a grantor trust) created a subtrust. The beneficiary of the subtrust created a second trust, which was a grantor trust with respect to the beneficiary. The subtrust wished to sell assets to the second trust, making it important that the subtrust also be a grantor trust with respect to the beneficiary. If it was, then the sale would not be an income-taxable transaction.

The subtrust granted the beneficiary a power to withdraw any assets *except* certain LLC interests. Once the LLC interests were converted into other assets, by virtue of the sale, then the sale proceeds could be withdrawn. And the withdrawal right was the element that would make the subtrust a §678 pseudo-grantor trust with respect to the beneficiary. (That section is the only grantor trust rule that treats someone other than the actual grantor as owner of a portion of a trust.) So the question was whether this right to withdraw the proceeds of the sale enough to cause the beneficiary to be treated as owner of the subtrust under §678 so that the sale itself would not be taxable?

The Ruling held that the beneficiary would be treated as owner of the subtrust under §678, because the beneficiary had the power to vest the proceeds of the sale in herself and those proceeds were the only subtrust asset after the sale. Thus, the sale would not be taxable, because both the subtrust and the second trust were treated as owned by the beneficiary. In essence, being treated as a grantor trust immediately after the sale was sufficient to be treated as a grantor trust at the prior instant when the sale itself occurred.

The Ruling analyzed in some detail the famous Rev. Rul. 85-13, which ruled (somewhat contrary to what one might think from reading the statute) that a person treated as owner of a grantor trust is taxable on the trust income *and* is treated as the owner of the trust's underlying assets for income tax purposes. In other words, the trust is simply ignored and the assets treated as if owned directly by the grantor or, in the case of §678, by the beneficiary who is treated as a pseudo-grantor. That generous treatment is reflected – maybe even extended – by this Ruling.

Remember that private letter rulings are not precedent. This Ruling is binding on the government with respect to the taxpayer who requested it, but use caution when conducting your own transaction.

LK

Proposed §67(e) Regulations

For the most part these newly issued proposed regulations confirm what we previously knew about which expenses of an estate or trust would be categorized as miscellaneous itemized deductions and which would not be viewed as miscellaneous itemized deductions. The distinction between miscellaneous itemized deductions and those expenses that would not fall into that category became even more important with the enactment of the 2017 Tax Act. After enactment of the 2017 Tax Act, miscellaneous itemized deductions were not just subject to the 2% floor these expenses were longer deductible at all. The characterization of expenses as miscellaneous itemized deductions in these proposed regulations is not surprising, and follows the guidance in prior regulations issued under §67(e).

Significant about these proposed regulations is the guidance provided on "determining the character, amount, and allocation of deductions in excess of gross income" that would be passed out to a beneficiary on termination of an estate or non-grantor trust. Since §67(e)(1) and (e)(2) remove from miscellaneous itemized deductions those items of deduction that are allowed to an estate and non-grantor trust, these regulations clarify that such deductions would continue to be deductible under §642(h) by the receiving beneficiaries on termination of the estate or trust.

Currently Treas. Reg. §1.642(h)-2(a) does not permit these deductions to be used in computing adjusted gross income and, as a result, are treated on the beneficiary's individual income tax return as miscellaneous itemized deductions that are entirely disallowed by new §67(g) (also added by the 2017 Tax Act). These proposed regulations clarify that deductions allowed under §67(e) are not miscellaneous itemized deductions and thus are not subject to elimination under §67(g). In addition, the proposal would revise Treas. Reg. §1.642(h)-2(a) to provide that, on termination of an estate or trust, the beneficiaries succeeding to the property would be entitled to take excess deductions, so that these excess deductions would not be treated as miscellaneous itemized deductions. Then, Treas. Reg. §1.642(h)-2(b) would specify how to determine the character and amount of excess deductions in the hands of the beneficiaries succeeding to the property on termination. The deductions would retain the same character as in the hands of the estate or trust.

Treas. Reg. §1.642(h)-5 provides various examples illustrating the application of §642(h). Example 1 illustrates how §642(h) works when the terminating estate or trust has a net operating loss, and Example 2 illustrates the operation of §642(h) in the absence of a net operating loss. The fiduciary would be required to allocate the deductions among the various items of income and notify the beneficiaries of the separate character of the excess deductions. The deductions that are directly attributable to a specific item of income must first be allocated to that item of income, and the remaining portion of such expense would retain its character and would be deductible on the basis of that character. The beneficiaries then will take those deductions as appropriate on their own return. For example, property tax incurred on real estate during administration will be deducted as part of the beneficiary's state and local tax deduction, and general §67(e) deductions will be deductible by the beneficiary in arriving at the beneficiary's adjusted gross income.

Although these proposed regulations will be effective after the regulations become final, the preamble specifically provides that "estates, non-grantor trusts, and their beneficiaries may rely on these proposed regulations" for any tax year beginning after 2017. Because fiduciaries and beneficiaries are given the option of using these proposed regulations for 2018 tax years, practitioners should communicate with beneficiaries of all estates or non-grantor trusts that had significant excess deductions on termination, whose final tax year started in 2018 or later, to let them know that the excess itemized deductions are fully deductible on their personal returns and to separately identify the character of such excess deductions for use by the beneficiaries on their personal returns.

KS

ERISA Spousal Annuity Trumped by Prenuptial Agreement

Estate of Harmon v. Harmon

2020 WL 1490932 (Pa. Sup. Ct.)

The Employee Retirement Income Security Act (ERISA) governs qualified plans and requires that a participant's surviving spouse must receive a survivor annuity payout of the participant's plan benefit. An exception applies if the spouse executed a waiver of that entitlement and a consent to the participant's designation of some other beneficiary or payout option. This spousal annuity mandate may conflict with state laws, such as Uniform Probate Code §2-804, that treat a spouse as having died before the participant in the event of a divorce, and thus purports to alter the rightful beneficiary of the decedent's plan benefits. *Egelhoff v. Egelhoff*, 532 U.S. 141 (2001), held that state laws like UPC §2-804 that impact qualified retirement benefits and employer sponsored life insurance are pre-empted by ERISA. The Court therefore concluded that divorce did *not* cause the former spouse in that case to be treated as predeceased for purposes of taking under the decedent's retirement plan beneficiary designation.

In re Estate of Sauers, 32 A.3d 1241 (Pa. 2011), rev'g 971 A.2d 1265 (Sup. Ct. Pa. 2009), is to the same effect as *Egelhoff*, involving a life insurance beneficiary designation (which was subject to ERISA because the insurance was part of an employee group benefit plan). Similar, too, is **Evans v. Diamond**, 2020 WL 2028522 (10th Cir.), involving a federal employee's Thrift Savings Plan account administered by the Federal Retirement Thrift Investment Board and subject to the Federal Employee Retirement Systems Act (FERSA). The decedent's thrift account designated the employee's spouse as beneficiary upon his death, which was not changed during the four years following their divorce.

Nevertheless, other cases have regarded *Egelhoff* as not dispositive. For example, the ERISA pre-emption provision applicable in *Egelhoff* does not apply to IRAs. See, e.g., *Lazar v. Kroncke*, 862 F.3d 1186 (9th Cir. 2017), citing *Stillman v. TIAA/CREF*, 343 F.3d 1311 (10th Cir. 2003).

As amended subsequent to *Egelhoff*, it also was thought that UPC §2-804(h)(2) might be a valid accommodation in some circumstances. For example, Gary, *State Statute Does Not Revoke Beneficiary Designation After Divorce*, 28 ESTATE PLANNING 376 (2001), explains the concept applied by §2-804(h)(2), that payment should be made to the designated beneficiary, as required by ERISA, but then a post-payment cause of action may be pursued by those individuals who would receive the benefits if the state law was valid. The plan administrator would honor the beneficiary designation, but state law would impose a constructive trust on that named beneficiary, which would direct the benefits to the "rightful" takers.

Hillman v. Maretta, 569 U.S. 483 (2013), aff'g 722 S.E.2d 32 (Va. 2012), expressly rejected that constructive trust approach, as applied by a Virginia statute very much like UPC §2-804(h)(2). According to both the Virginia and United States Supreme Courts, the Virginia provision imposing a constructive trust violates Congressional intent that the designated beneficiary be guaranteed receipt *and enjoyment* of the benefits involved. *Hillman* addressed an insurance beneficiary designation that was subject to the Federal Employees' Group Life Insurance Act (FEGLIA), not a qualified plan subject to ERISA. Nevertheless, *Hillman* cast significant doubt on the UPC backdoor retraction of the former spouse's entitlement, as being inconsistent with the objectives of ERISA pre-emption. As does *Evans*, involving FERSA and, in reliance on *Hillman*, holding that "requiring [the surviving spouse] to hold monies . . . in a constructive trust is the economic equivalent of an order directing that those monies be distributed to the [decedent's] Estate. Such an order would frustrate the scheme adopted by Congress in FERSA" and "would interfere with the express federal interest of ensuring that . . . the properly designated beneficiary, retain the entirety of the distribution . . . ."

Hillman specifically mentioned *Egelhoff* but, curiously, it did not refer to *Kennedy v. DuPont Sav. & Invest. Plan*, 555 U.S. 285 (2009), which is consistent with the *Egelhoff* notion that the plan administrator must honor the beneficiary designation and disregard any allocation of property rights in a divorce decree (unless it is a QDRO). The Court's rationale, expressly stated, was that plan administrators should not be required to inquire beyond plan documents and records to determine whether other documents, agreements, or orders alter the proper distribution of plan benefits. *Kennedy* did *not* address the proposition that payment should be made to the former spouse as the designated beneficiary, followed by recovery by the estate based on the spouse's waiver of all rights in such property. But the *Kennedy* Court's footnote 10 *suggested* that the former spouse's *waiver* of rights pursuant to a divorce property settlement may suffice to permit the decedent's estate or its beneficiaries to compel distribution of the proceeds from the former spouse as the designated beneficiary to those rightful takers.

This is the logic of the UPC §2-804(h)(2) constructive trust approach, as held in *Estate of Kensinger v. URL Pharma Inc.*, 674 F.3d 131 (3d Cir. 2012). *Kensinger* was cited with approval in *Moore v. Moore*, 2019 WL 6242193 (Ala.), which held that a constructive trust also will be imposed on a surviving spouse who executed a prenuptial agreement renouncing all rights to retirement accounts of the decedent. The court held that the plan administrator's payment to the spouse was proper under ERISA, because the spouse never executed a waiver or consent to the decedent's designation of a different beneficiary, but then the spouse was required to turn those proceeds over to the designated beneficiary.

Kensinger also was relied upon in *Estate of Harmon*, which involved a property settlement incident to divorce, in which the decedent's surviving spouse also waived all interest in the decedent's "annuities, . . . life insurance, employee benefits and any pension plan, profit sharing plan, and/or retirement funds or accounts" and agreed to "execute, acknowledge, and deliver" any instrument needed to fulfill the waiver and relinquishment of any interest in those assets. The decedent failed to change the beneficiary of employer-funded life insurance, administered by a fund that was subject to ERISA, which obligated the insurer to pay the proceeds to her. The court nevertheless held that payment of the proceeds to the surviving former spouse relieved the insurer of its obligations but did not relieve the former spouse of the contractual obligation of the property settlement agreement by turning them over to the secondary beneficiary named in the insurance policy.

The suggestion in *Kennedy*, and the holdings in *Kensinger*, *Moore*, and *Harmon* are consistent with footnote 4 in the *Hillman* opinion. It expressly identifies a statutory exception (to the Court's holding that the beneficiary designation normally controls, notwithstanding state law) that applies if the named beneficiary is in conflict with "the terms of any court decree of divorce, annulment, or legal separation." Or, it would seem in *Moore*, in conflict with the terms of the prenuptial agreement. So, without saying so, *Hillman* (and now *Moore* and *Harmon*) may be consistent with *Kennedy* and together they may inform a conclusion that one way to prevent the named beneficiary from taking insurance or retirement benefits that are subject to a Federal pre-emption regime is to provide for a different distribution in a pre-nuptial agreement, or a decree of divorce, annulment, legal separation, or property settlement incident thereto.

In a divorce context, the other surefire approach is to change the beneficiary. And, in a case like *Moore* that does not involve divorce, to obtain the spouse's promised waiver and consent. Otherwise, reliance on state law to accomplish the change of beneficiary result probably will not suffice if any Federal program with pre-emption is involved.

It bears noting that most estate planners realize that any change in marital status – especially a divorce – is an appropriate time to reconsider a client's estate plan. By all appearances, not as many divorce lawyers are aware that state laws may alter a beneficiary designation upon divorce, which requires that the client obtain expert assistance from an experienced estate planner. Estate planners and family lawyers, working together, might better ensure that their mutual clients will achieve their ultimate dispositive goals.

JP

Fraudulent Transfer into Trust

United States v. Harding

2020 WL 1234633 (E.D. Cal.)

Perhaps the only surprise in *Harding*, adopting the recommendation in 2020 WL 838439 (Magis. E.D. Cal.), is that the taxpayer thought that maybe his endeavor would work. Six months after acquiring an asset the defendant transferred it into a self-settled asset protection trust, "created by Harding to shield assets from his creditors," including the federal government. Three months later the United States filed suit against the defendant to reduce to judgment unpaid federal income tax assessments for a dozen years, all prior to acquisition and transfer of the trust corpus. Salient was that the trust "does not have a valid Taxpayer Identification Number, but has used a fictitious one; has never filed tax returns; does not have federal or state records; uses the same mailing address as defendant Harding; has had checks deposited on its behalf by defendant Harding; and has been used as a vehicle for other property purchases by Harding, among other things."

Without ever reaching an alter ego or nominee trust assertion, the court declared the subject trust asset to be subject to the government's collection action because the transfer to the trust, via quitclaim deed, was not effective under the California version of the Uniform Fraudulent Transfer Act.

JP

Joint Tenancy Safe Deposit Boxes

In re Estate of Taylor

2019 WL 5275029 (Ks. Ct. App.)

Taylor states the traditional but, to many, the unfamiliar notion that a joint tenant safety deposit box is only that: the box allows access to the multiple renters, and the ability of each to keep assets safe therein. But the fact that the box allows access to multiple individuals does not make contents of the box joint tenancy assets. Nor does storage of assets in the joint-access box constitute a gift, or authority for others with access to the box to take those assets for themselves. A joint tenant in the box cannot claim joint ownership of assets stored in the box without establishing the traditional elements of a gift. Which may require that claimant to overcome a presumption against a gift, such as that the grant of access to the safe deposit box was to assist the rightful owner of the contents with management of the property during life, or to provide easier access to the box after that owner's death.

JP