RECENT ESTATE PLANNING DEVELOPMENTS

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I. Legislation Relating to Estate and Gift Tax

A. Recent legislation: To be announced by the end of December—we think!

1. Under the Economic Growth and Tax Relief Reconciliation Act of 2001 (the Bush tax bill), the federal estate tax is scheduled to be repealed as of January 1, 2010 (and replaced with a "new, improved" carryover basis regime). However, because of gyrations in the Senate (having something to do with the Budget Reconciliation Act and the "Byrd Rule" in the Senate), the repeal expires December 31, 2010, and on January 1, 2011, the law as it existed in 2001—including a $1,000,000 exemption equivalent—will arise from the ashes. Is this going to happen? The near-universal consensus—*er*, speculation—is that some rather pressing problems facing Congress (an understatement!), by the end of the Congress will extend the 2009 rules for another year, meaning that instead of an estate-tax-free year in 2010, we will see an exemption equivalent of $3,500,000 and an estate (and GST) tax rate of 45 percent. The will give Congress time to decide what to do on a permanent basis. (The term "permanent" is used with some trepidation, given the constant roiling of our transfer tax laws that began with the Tax Reform Act of 1976.)

    1. **The most "recent" pronouncement**. Daily Tax Reports (6/3/09) reported that on June 2, Senate Finance Committee Chair Baucus (D-Mont.) said that Senate tax writers will address the estate tax at some point this year, despite the stack of legislation piling up on the committee's agenda. When asked if the Finance Committee would be able to address the estate tax in 2009 despite also having to work on health care reform, cap-and-trade legislation, and other hot button issues, Baucus said the committee would find the time. "We have to. I'm not going to let it be zero next year."

B. SB 722, introduced on March 26, 2009.

SB 722, introduced on March 26, 2009. Of the several estate tax bills introduced earlier this year, this is the most significant one because it was introduced by Sen. Max Baucus, the chair of Senate Finance.

1. **$3.5 million exemption equivalent (with inflation adjustment) and 45 percent tax rate.**

2. **Gift tax recoupled with estate tax**. The $3.5 exemption equivalent under the estate tax also would apply under the gift tax.

3. **Portability of spouse's estate tax exemption equivalent**. There has been wide interest in and support for the portability concept, under which any unused exemption equivalent of the deceased spouse would be carried over to the surviving spouse. Under this change, an "all my property to my spouse" would no longer lead to estate stacking for estate tax purposes. SB 722 adopts the portability concept in the context of the estate tax exemption equivalent, but not with respect to a deceased spouse's unused GST exemption.

    a. **To prevent spouse-stacking, cap placed on amount of carryover**. "The term 'aggregate deceased spouse unused exclusion amount' means the lesser of (A) the basic exclusion amount and (B) the sum of the deceased spousal unused exclusion amounts computed with respect to each deceased spouse of the surviving spouse."

b. **Estate of deceased spouse would have to file and make election on estate tax return**. To secure the carryover of the deceased spouse's unused exemption equivalent, the spouse's executor would have to file a timely (including extensions) estate tax return.

c. **Statute of limitations would remain open**. "Notwithstanding any period of limitation under section 6501 … the Secretary may examine a return of the deceased spouse to make determinations with respect to such amount"—after the surviving spouse dies, no doubt.

C. HR 498, introduced on January 19, 2009. This bill was introduced by Representative Mitchell (D. Ariz.) and referred to the Ways and Means Committee.

1. **$5 million exemption equivalent (with inflation adjustment) and 45 percent tax rate for estates under $10 million.** The bill would increase the exemption equivalent to $5,000,000, phased in gradually: $3,750,000 in 2010, $4,000,000 in 2011, with annual increases of $250,000 until the $5,000,000 level is reached in 2015. Beginning in 2016, the $5,000,000 amount would be adjusted annually for inflation.

   a. The 45 percent estate tax rate would be retained. However, the tentative tax would be increased for taxable estates over $25 million.

2. **Gift tax recoupled with estate tax**. As under SB 722, the exemption equivalent under the estate tax also would apply under the gift tax.

3. **Repeal of §2058 estate tax deduction for state death taxes for estates of decedents dying after 2009.**

4. **Portability of spouse's exemption equivalent.** This portion of the bill is similar to the language of SB 722. In fact, the two bills' language dealing with keeping the statute of limitations open is identical.

D. HR 436, introduced on January 9, 2009. This bill was introduced by Rep. Earl Pomeroy (D. N.Dak.), a member of the House Ways and Means Committee. The bill states in the preamble that its purpose is "[t]o amend the Internal Revenue Code of 1986 to repeal the new carryover basis rules in order to prevent tax increases and the imposition of compliance burdens on many more estates than would benefit from repeal, to retain the estate tax with a $3,500,000 exemption, ***and for other purposes***." It is those "other purposes" that were attention-grabbers, as they would have an enormously negative impact on valuation and minority discounts.

1. **$3.5 million exemption equivalent and 45 percent tax rate.** The bill would retain the $3,500,000 exemption equivalent and the 45 percent estate tax rate. However, the tentative tax would be increased by an amount equal to 5 percent on amounts over $10 million, with the amount of the increase not to exceed the sum of the applicable credit amount under section 2010(c) and $119,200. Carryover basis would be repealed. This portion of the bill would have an effective date of December 31, 2009.

2. **Goodbye to valuation discounts.** A new §2031(d) would provide that "the value of any nonbusiness assets held by the entity shall be determined as if the transferor had transferred such assets directly to the transferee (and no valuation discount shall be allowed with respect to such nonbusiness assets)." A nonbusiness asset is defined as "any asset which is not used in the conduct of one or more trades or businesses." The

definition of nonbusiness assets includes "passive assets," and the bill lists five categories of assets that are deemed to be passive assets.

3. **Goodbye to minority discounts and hello to family attribution.** A new §2031(e) would provide that "in the case of the transfer of an interest in an entity other than an interest which is actively traded (within the meaning of section 1092), no discount shall be allowed by reason of the fact that the transferee does not have control of such entity if the transferee and members of the family (as defined in section 2032A(e)(2)) of the transferee have control of such entity."

4. **This bill has a "history."** Because there was speculation afloat that Pomeroy had introduced a similar bill in the past, I had my research assistant look into the matter, and he uncovered the following facts. First, HR 436 has no co-sponsors (which is mildly unusual). Mr. Pomeroy is the 10th most senior Democrat on the House Ways and Means Committee and either 109th or 106th (according to different sources) in overall House seniority. Since 1993, Mr. Pomeroy has introduced 115 bills, two of which have been enacted. "I am not very steeped in the ways of Congress," says my research assistant, "but that does not seem like a particularly high rate of success."

    a. My research assistant found that Mr. Pomeroy introduced the same bill in 2002 as an amendment to H.R. 2143 (failing 197-231) and then as H.R. 5008. In 2003, these provisions were again introduced as an amendment to H.R. 8 (failing 188-239). In 2005, these provisions were introduced, first as H.R. 1577 (which was referred to Ways and Means), then as an amendment to H.R. 8 (failing 194-238). Finally, in 2007 these provisions were introduced as H.R. 4242 (again referred to Ways and Means, where it died).

    b. "As near as I can tell," says my assistant, "the valuation provisions in each of these attempts was exactly the same as (or at least very similar to) those in H.R. 436."

E. **What may happen to valuation discounts?** Given the record deficits and the costs of all of the bailouts, whatever Congress does with the estate tax is likely to be accompanied by revenue offsets—and valuation discounts, obtained through entities such as LLCs and FLPs, are likely to be at the top of the list. History suggests what such proposals might be.

1. **Limit discounts to active businesses**. This was proposed by the Clinton administration in 1999 (and again in 2000 and 2001). The 1999 proposal "would eliminate discounts except as they apply to active businesses. Interests in entities would be required to be valued for transfer tax purposes at a proportional share of the net asset value of the entity to the extent that the entity holds readily marketable assets (including cash, cash equivalents, foreign currency, publicly traded securities real property, annuities, royalty-producing assets, non-income producing property such as art or collectables, commodities, options and swaps), at the time of the gift or death." The 2000 and 2001 proposals changed "readily marketable assets" to "non-business assets."

2. **Aggregation rules may be on the table**. A January 27, 2005 report by the Staff of the Joint Committee on Taxation addressed both lack of control discounts and marketability discounts.

    a. **Control discounts**. The JCT Staff suggested both a transferor aggregation rule (the interest transferred would be valued at a proportional share of the total interest owned by the transferor before the transfer) and a transferee aggregation

rule (the interest received by the transferee would take into account assets already owned by the transferee). Example: If Father owned 80 percent of an entity and gifted 40 percent to Son, under the transferor aggregation rule the interest would be valued at one-half of the 80 percent interest owned by Father. If Father dies and bequeaths the remaining 40 percent to Son, under the transferee aggregation rule the bequeathed interest would be valued at one-half of the 80 percent interest now owned by Son, including the 40 percent previously gifted to Son. Interests of spouses would be aggregated with transferors and transferees.

b. **Look-through rule as to marketable assets**. The JCT Staff report also suggested that the portion of an interest in an entity represented by "marketable assets" would be valued at its pro rata share of the marketable assets if such assets represented at least one-third of the value of the entity's assets.

F. Other recent legislation

1. **Worker, Retiree and Employee Relief Act of 2008 ("WRERA"): Minimum required distributions suspended for 2009 (only).** The problem: Paul has an IRA whose balance, on December 31, 2007, was $400,000. As Paul was 74 years old, his required minimum distribution in 2008 was [$400,000/14.1 =] $28,369. However, by the end of November 2008 the balance in his IRA had dropped to $240,000—and there were a lot of "Pauls" in this very troublesome circumstance. There was an effort to suspend required minimum distributions for 2008, but it didn't come to pass. However, a new §401(a)(9)(H) provides that required minimum distributions are suspended—for 2009 only.

   a. The suspension applies only to IRAs and defined contribution plans under §§ 401(a), 403(a), 403(b), and 457. The suspension does not apply to distributions from a defined benefit plan.

   b. **Effect on distributions under five-year rule**. If a participant dies before the required beginning date and has no designated beneficiary, the plan benefits must be distributed within five years. Under WRERA, the five-year period is determined "without regard to calendar year 2009." §401(a)(9)(H)(ii)(II). Effectively, the five-year rule becomes a six-year rule for participants who died between 2004 and 2009.

2. **WRERA: Non-spousal rollovers.** A number of qualified plans do not offer a life expectancy distribution option to non-spouse beneficiaries. In this situation, these plans provide for distributions either in a lump sum or over five years. The Pension Protection Act of 2006 ("PPA") contained some good news for non-spouse designated beneficiaries. The Act allowed non-spouse beneficiaries to roll over distributions from a qualified plan, just as surviving spouses have always been able to do, provided that the rollover is made by December 31 of the year following the year of the participant's death. This would enable the beneficiary to take distributions over his or her life expectancy, using the Single Life Table. It seemed clear (at the time) that the Congressional intent was to give non-spouse beneficiaries the ability to stretch distributions over their life expectancies via a "stretch IRA."

   a. The bad news was that the statute was unclear as to what would happen if a plan did not offer the rollover option. Notice 2007-7, 2007-5 I.R.B. 395, giving guidance on the PPA's provisions, stated that "[a] plan is not required to offer a rollover of a distribution to a nonspouse beneficiary." This raised a disturbingly

clear implication that a rollover could not be made if the plan did not offer this option.

a. WRERA clarifies this by requiring that qualified plans offer this option—***but only for 2010 and thereafter***.

G. What has happened to issues raised in the Priority Guidance Plan 2007-2008 and 2008-2009 projects? A lot!

1. **Charitable lead trust ordering provisions**. The Service has issued proposed regulations under which ordering provisions in CLTs, under which the "bad" income (ordinary income) is first distributed to the charity, will not be respected. Prop. Reg. §1.642(c)-3 and §1.643(a)-6. Under the proposed regulations, unless the CLT's ordering provisions have an economic effect, they will be disregarded in determining the character of income paid permanently or set aside for the charity. The regulations give as a "no-go" example a CLAT provision under which distributions in satisfaction of the annuity are first to be paid from ordinary income, second from short-term capital gain, third from 50 percent of UBTI, fourth from long-term capital gain, fifth from the balance of UBTI, and last from tax-exempt income. Instead, the distribution to charity that qualifies for a deduction under §642(c) is deemed to consist of a proportionate share of all classes of income.

2. **Charitable lead unitrust sample forms.** The Service has published sample CLUT inter vivos forms (Rev. Proc. 2008-45, 2008-30 I.R.B. 224) and sample CLUT testamentary forms.

   a. **Third-party nonfiduciary substitution power given tacit approval**. In recent years, there has been considerable discussion in the literature and at CLE programs as to whether, as a means of making an inter vivos trust a grantor trust, it is "safe" to use a §675(4) power under which a third party is given a nonfiduciary power to substitute assets of equal value. Among the concerns is that nobody really knows what it means to exercise a power in a nonfiduciary capacity; and that all of the PLRs on the issue close with the admonition that whether a substitution power turns out to have been exercised in a nonfiduciary capacity is a fact question the Service can second-guess later.

   Interestingly, the sample grantor trust forms contain such a substitution power, as did the sample CLAT forms that were published in 2007.

3. **Division of charitable remainder trusts**. Over the years, a number of PLRs have been issued as to the effect of an early division of a CRT with multiple lead beneficiaries into separate trusts, one for each beneficiary. Section 5 of the 2008 Rulings Revenue Procedure stated that this issue was on the "no rulings" list until further guidance was issued. That guidance came in Rev. Rul. 2008-41, 2008-30 I.R.B. 1, addressing the division of CRTs into new separate CRTs on a pro rata basis. A pro rata division (i) does not result in a failure to qualify as CRTs, (ii) is not a sale, exchange or other disposition producing gain, (iii) the basis of each separate trust's share of each asset is the same share of the basis before the division, (iv) is not an act of self-dealing, and (v) is not a taxable expenditure under §4945.

   a. **Non-pro rata divisions not addressed**. The Revenue Ruling does not address the consequences of a non-pro rata division of trust assets.

4. **Bombshell under §2704 regulations?** Section 2704(b)(4) gives the Secretary authority to issue regulations regarding a restriction that has "the effect of reducing the value of the transferred interest for purposes of this subtitle, but does not ultimately reduce the value of such interest to the transferee." For the past six years, (beginning in 2003-2004), the Priority Guidance Plan has included "guidance under §2704 regarding restrictions on the liquidation of an interest in a corporation or partnership." At the Fall 2008 ACTEC meeting, Cathy Hughes, of Treasury's Office of Tax Policy, said that work on such regulations is "at the top of the list," and that they would likely issued by the end of the year. Needless to say, that did not happen. There have been rumblings that the regulations, if and when they are published, will address some of the grounds for valuation discounts in FLPs and LLCs.

H. Joint Committee on Taxation. On April 4, 2008, the Staff of the Joint Committee on Taxation published a report titled "Taxation of Wealth Transfers Within a Family: A Discussion of Selected Areas of Possible Reform." In addition to discussing several of the reform proposals mentioned above (*e.g.*, portability of spouse's exemption equivalent, valuation discounts), the report mentioned limiting dynastic trusts by making the GST exemption shelter only one generation of skips, and eliminating or drastically limiting the use of Crummey withdrawal powers as a means of securing gift tax annual exclusions.

1. No mention of zero-out GRATs. There have been rumors that Treasury, or someone, was going to make recommendations aimed at curtailing the use of short term zero-out GRATs, perhaps by amending the rules to require that the remainder interest be of a value of at least 10 percent of the value of the transferred interest. To date, however, that appears to be just a rumor. This is not mentioned in the JTC report, and none of the "estate tax" bills that were introduced earlier this year addressed this issue.

I. Freeze on new and pending regulations. On January 26, 2009, President Obama's Chief of Staff Rahm Emanuel sent a memo to the heads of executive departments and federal agencies stating that unless related to an emergency situation or other urgent circumstances, no proposed or final regulation were to be sent to the Office of the Federal Register (OFR) for publication until it has been reviewed and approved by a department or agency head appointed or designated by the President. Proposed or final regulations that have not been published in the Federal Register should be withdrawn from the OFR so they can be reviewed and approved, and the recipient should consider extending for 60 days the effective date of regulations that have been published in the Federal Register but not yet taken effect "for the purpose of reviewing questions of law and policy raised by those regulations." Federal Register, 1/26/09, Volume 74, Number 15, page 4435.

II. Some Comments on Planning and Drafting in a New World (the $3,500,000 exemption equivalent) and an Uncertain World

A. Introduction. Speaking to the Austin Tax Study group on January 20, 2009, Al Golden (Ikard & Golden, P.C.) began with a most propitious (and sadly timely) quotation from Charles Dickens' *A Tale of Two Cities*: "It was the best of times, it was the worst of times; it was the age of wisdom, it was the age of foolishness; it was the epoch of belief, it was the epoch of incredulity; it was the season of Light, it was the season of darkness; it was the spring of hope, it was the winter of despair…."

1. **One thing is certain: a $3,500,000 exemption equivalent has impacted the planning decisions of a sizeable number of clients.**

2. **But there are so many uncertainties!** I'm speaking of the uncertain future of our transfer tax laws, but even more of the uncertainty in the current financial, housing, economic, etc. etc. situation. Here are some observations about the changed (and changing!) rules that may be helpful in dealing with your clients.

B. Bypass trusts continue to be desirable (for most clients) even with a $3,500,000 exemption equivalent.

1. **The $3,000,000 estate.** Scenario: Henry and Wanda, in their 70s, have a $3,000,000 combined marital estate, and there no hot assets (or even lukewarm assets) that have any real chance of exploding in value. The wills you drafted for them several years ago (when the exemption equivalent was $1,000,000 or $1,500,000) reflect standard marital planning: A formula pecuniary gift to the trustee of a QTIPable trust, and a residuary credit shelter trust. Since the likelihood is high that the surviving spouse's estate will be under $3.5 million, is there any reason for their wills to create a residuary bypass rather than a two-will that gives the surviving spouse the freedom and flexibility of outright ownership?

   a. Of course, this is a no-brainer if either Henry or Wanda have children by a first marriage: a trust is strongly desirable to insure that on the surviving spouse's death the property passes by remainder to Henry's family, not Wanda's family.

   b. But Henry and Wanda have been married for years, and all of his kids are also her kids. Besides, Henry and Wanda like the idea of an "all my property" will: It's easy to understand, and it gives the surviving spouse the freedom and flexibility of outright ownership. Should we even consider recommending a testamentary trust in this homely, homey scenario?

   Yes; there are strong reasons for their wills to contain testamentary trust provisions.

   a. **Creditor protection via a spendthrift clause**. But professor—how likely is it that this middle-America couple, retired and not involved in any transactions more sophisticated than shopping at Piggly Wiggly, will have creditor problems? Answer: All it would take is an accident on I-95 in which the client is the *allegedly* negligent driver, with liability projected to exceed the liability limit on his or her GEICO policy.

   b. **Second spouse protection**. A trust can give protection against the possibility that after Wanda dies, Henry meets Lola LaTour, who owns a double-wide at a nearby trailer park.

   c. **Incapacity protection**. Should the surviving spouse loses his or capacity, an "all my property" will would likely lead to a guardianship administration. While Henry and Wanda have each given the other a durable power of attorney and have named Trusted Daughter as alternate attorney-in-fact, there's never a guarantee that a durable power will resolve all of the property and other issues that may arise. A trust avoids the guardianship or conservatorship issue altogether.

2. **The $6,000,000 community estate.** Scenario: Homer and Wendy, in their 60s, have a $6,000,000 community estate. The wills you drafted for them several years ago reflect standard marital planning: A formula pecuniary gift to the trustee of a QTIPable trust, and a residuary credit shelter trust. If either had died in 2005, with a $1.5 million exemption equivalent there would have been a $1.5 million formula marital gift, and the bypass trust would be funded in the range of $1.5 million. If either had died in 2008, with a $2 million exemption equivalent there would have been a $1 million or so formula marital gift, and the bypass trust would be funded in the range of $2 million. But if either dies in 2009 or later, with a $3.5 million exemption equivalent there will be no marital deduction gift, and the decedent's entire estate will fall into the bypass trust. Such a trust has advantages—see above. But what does that residuary bypass trust say? It may be that the client will want to retool its terms.

    a. If the trust says "all income at least annually to my spouse" (the same as would have been in the now-nonexistent QTIP marital trust) and the client is happy with that (although we might recommend a remarriage provision), fine. But many bypass trusts provide for discretionary distributions of income (as well as principal), and the class may include descendants as well as the spouse. Some clients may be troubled by the fact that (with no QTIP trust in play) the spouse will not have a mandatory income interest entitlement.

    b. If the client has that concern, there are a variety of options available—but the central point is to have that discussion with the client(s)—that their estate plans have been changed by events. Possibilities include a unitrust-type payout, or perhaps two residuary trusts—one with mandatory income to the spouse and the other for the descendants. The central point is to find out what the clients want and then implement it.

        (1) Yeah; but why worry about that? Doesn't the spouse have unrestricted access to her one-half community share—in my example some $3 million? Shouldn't she spend it down—in effect, be forced to spend it down? That may make sense to an economic animal, but most clients are not economic animals. This is especially for clients old enough to "remember the depression"—and now find themselves in another depression. The spouse is not likely to feel secure in spending down her assets.

3. **But it wasn't supposed to go all to the marital trust!** Scenario: Howard, married to Wilma, had two children by his first marriage (and Wanda also has two children by her first marriage). Having concluded that income from a QTIP trust would be sufficient for Wilma (who has a substantial estate from her first marriage), the residuary trust under Howard's will benefits only Howard's first-marriage family. Howard died in April 2007, survived by Wilma. After electing an extension to file, the Form 706 was filed on July 11, 2008. Although Howard left a $4,000,000 estate ($3 million Howard's separate property and $1 million his one-half community interest), his will contained a ***pecuniary*** marital deduction formula gift to a QTIPable trust, and thus no estate tax was due. A closing letter has been received, and it is time to fund the QTIP marital trust and the bypass trust. The only problem is that Howard's estate has dropped in value to $2.2 million. As a result, $2 million in assets will go to fund the QTIP marital trust, leaving only $200,000 to fund the bypass trust.

a. In retrospect, the situation would have been better if the marital deduction formula gift in Howard's will made a ***fairly representative*** pecuniary gift. At least the two trusts would be treated equitably—that is, equally poorly.

b. In my example, it's too late to help Howard, and he doesn't care anymore anyhow—he's dead. But suppose Howard is alive, and Howard and Wilma are your clients. What are you going to tell them?

c. ***I don't know what you are going to tell Howard and Wilma***, but I do know this: You need to talk to them; or, more precisely, Howard and Wilma need to reassess their estate plans (with your guidance) in light of (i) the $3.5 million exemption equivalent, and (ii) the disruption in family finances caused by the market turmoil. And of course I'm not just talking about Howard and Wilma; I'm talking about ***just about every client in your estate planning client base***. Whether by way of a newsletter or (my preference) a personal letter (and most clients can get the essentially same personal letter), clients may be advised—warned—that items (i) and (ii) may have drastically altered their estate plans, and that a review in the near future is called for.

4. **And what about state estate taxes?** In states that "decoupled" from the federal estate tax system or have some other succession tax, exemptions are invariable lower than $3.5 million. In these states, fully funding a spousal bypass trust with $3.5 million will result in substantial state death taxes—in New York, in the range of $230,000 in state death taxes on the death of the first spouse. One way to address the problem in marital planning would be to alter the marital deduction formula clause to limit the bypass trust to the amount that will result in no federal *or state* estate taxes. The disadvantage of this approach is that a significant portion of the decedent's federal estate tax exemption equivalent will be "wasted," and the marital gift may be overfunded.

   a. This problem could be encountered even in Florida or Texas, or other states that do not have a succession tax—if the client owns real property situated in another state. In this situation, it may be appropriate to "convert" the real property into personal property, *e.g.*, by transferring the property to an LLC.

C. **Now may be a good time for that client to give away those securities that have plummeted in value—especially if the client is in bad shape.** This is particularly true if the client firmly believes that the securities are going to rebound in the near future. (Hope springs eternal!) Because the assets have gone down in value, the client can give away more shares at no gift tax cost (by staying within the $1 million gift tax exemption equivalent) than she could have given away a year or two ago. With the financial world in which many clients now find themselves, I thought it appropriate to add the following problem to my Estate Planning materials:

Some years ago, Mary purchased 1,000 shares of Zebra common stock at $60/share, for a total purchase price of $60,000.

1. Mary gives the 1,000 shares of Zebra stock to her daughter Donna, a stock broker in Dallas. At the time of the gift, the fair market value of the Zebra stock is $40/share ($40,000). If Donna later sells the stock, what is Donna's income tax basis in the stock (i) for purposes of determining loss—and what is the purpose of this rule; (ii) for purposes of determining gain?

2. Several months later, Donna sells the stock at $50/share ($50,000). What are the income tax consequences?

3. Disregard paragraphs (1) and (2). Mary, 72 years old and in poor health after suffering a heart attack, has a will that bequeaths the Zebra stock to Donna. The fair market value of the Zebra stock is $40/share ($40,000). What should Mary consider doing?

D. **How old will the client's children be when they get "their" inheritance?** Don't get me wrong; the notion that children have a "right" to inherit anything is against my grain (although it is a fertile source of attorneys' fees in fiduciary litigation!). Speaking personally, the six Johanson children have *had* their inheritance—we raised them and paid for their educations. If there's anything left after Mr. and Mrs. J leave the scene, well and good—but the children shouldn't be counting on it.

However, the reality is that for clients with children, the children are going to take a share of the clients' estates someday. And "someday" is the controlling term here. Another change is taking place—not as sudden and dramatic as the increase in the exemption equivalent or the drop in the Dow Jones, but at a gradual pace. People are living longer, and that means that surviving spouses are living longer. Where all of the client's estate is in a trust or trusts that provide for income to Wendy for life, remainder to the children, how old will the children be when their remainder vests in possession? If Wendy is 70 years old, her life expectancy is 18 years. In all likelihood, the "children" will be in their 60s. As Roy Adams put it (and this is a paraphrase), "What are they going to do with their inheritance? Get a hip replacement? By a new hearing aid?"

1. This should be discussed with clients (or that widowed client). Perhaps gifts to the children would be in order even if the children don't "need" it.

2. Another observation. If the clients are in their 70s, the children are likely to be in their 40s, which means that they are coming up on what has become a serious financial issue—paying for *their* children's college education, with tuitions at obscene levels. Some clients may want to consider a truly direct skip transfer to a trust for the benefit of grandchildren, to help the children over this education-financing hump. And remember: clients now have $3.5 million in GST exemption to play around with.

III. Section 401—Qualified Plans and IRAs

A. **"Divorce revokes" statute does not apply to qualified retirement plans.** As with a similar statutory rule that applies to wills, many states have statutes [*e.g.*, Texas Family Code §9.302] under which divorce revokes a pre-decree designation of the former spouse as beneficiary of a pension plan or individual retirement account. As applied to qualified plans governed by ERISA, however, such statutes were effectively overturned by the Supreme Court in *Kennedy v. Plan Administrator*, 129 S.Ct. 865 (2009), involving the Texas statute. The court held that the administrator of a qualified plan was required by ERISA to pay a pension plan benefit to the beneficiary named by the plan participant, notwithstanding the parties' divorce and notwithstanding that the ex-wife had waived her entitlement in the divorce decree. But while the court resolved that issue, it left open—actually, invited—the possibility that the participant's alternate beneficiary can bring an action against the ex-spouse to recover the plan proceeds.

1. K had named his wife Liv as beneficiary of his DuPont savings and investment plan but did not name an alternate beneficiary, meaning that K's estate was the default beneficiary. The parties subsequently divorced, and in the divorce degree Liv was "divested of all right, title, interest, and claim in and to ... [a]ny and all sums ... the proceeds [from], and any other rights related to any ... retirement plan, pension plan, or like benefit program existing by reason of [K's] past or present or future employment." However, K did not execute any documents removing Liv as beneficiary (although he did so with respect to his DuPont pension and retirement plan). On K's death, his executor asked the plan administrator to pay the SIP plan proceeds to K's estate. Instead, the administrator paid the $400,000 to Liv.

2. The Court of Appeals for the Fifth Circuit had ruled that Liv's waiver in the divorce decree violated ERISA's anti-alienation provision and was ineffective. That court pointed out that the only exception to the anti-alienation rule was a qualified domestic relations order, and that since the Kennedy divorce decree did not include QDRO provisions, the waiver could be not be recognized. "ERISA provides a specific mechanism—the QDRO—for addressing the elimination of a spouse's interest in plan benefits, but that mechanism is not invoked." 497 F.3d 426 (5th Cir. 2007). The Supreme Court rejected that analysis, and concluded that ERISA's anti-alienation provisions are not a bar to a spouse's waiver. A QDRO addresses only the manner in which plan benefits are to be paid, and is not a mechanism for renouncing a claim to benefits. But while the Fifth Circuit's analysis was rejected, the Supreme Court affirmed the decision on another ground. Citing policy reason as well as statutory language, the court concluded that "the plan administrator did its statutory ERISA duty by paying the benefits to Liv in conformity with the plan documents."

3. Although the Supreme Court resolved that issue, it did not resolve the final outcome of the case. In footnote 10, the court stated that it did not "express any view as to whether the Estate could have brought an action in state or federal court against Liv to obtain the benefits after they were distributed." The footnote includes a "compare" cite to *Boggs v. Boggs*, 530 U.S. 833 (1997), where in dictum the court stated that "[i]f state law is not preempted, the diversion of retirement benefits will occur regardless of whether the interest in the pension plan is enforced against the plan or the recipient of the pension benefit," in contrast to two state court cases in which such actions were upheld. In *Pardee v. Pardee*, 112 P.3d 308 (Okla. App. 2004), the court ruled that "the pension plan funds were no longer entitled to ERISA protection once the plan funds were distributed." In *Sweebe v. Sweebe*, 712 N.W.2d 708 (Mich. 2006), after noting that "[t]his issue is governed exclusively by Michigan law because the proceeds have been properly distributed under ERISA," the court pointed out that *Boggs* involved pre-distribution funds. Here, said the court, once benefits are distributed "the consensual terms of a prior contractual agreement may prevent the named beneficiary from retaining those proceeds."

4. When such a case arises in Texas or in a state with a similar statute with, as it assuredly will, I should think that the alternate beneficiary's chance of recovery would be strengthened by a state statute that eflects a legislative policy that ex-spouses should not be allowed to retain retirement plan benefits.

B. Beneficiary designation "as stated in wills" didn't work out too well. Ltr. Rul. 200846028 was issued in response to a ruling request "as supplemented by correspondence dated May 4, 2007, December 6, 2007, January 4, 2008, May 14, 2008 and June 13, 2008." The beneficiary designation for A's IRA was "as stated in wills," with no alternate beneficiaries named. The residuary estate under A's will was poured over to a trust that became irrevocable on A's death. Under the trust, after the distribution of various parcels

of real estate, the trust estate is to be distributed to eight beneficiaries, one of whom is B. A's executor obtained a local court ruling that the phrase "as stated in wills" was a specification of the trust as beneficiary, and that the eight named beneficiaries are to be treated as designated beneficiaries. (You can imagine how much shrift the National Office gave the court order!)

1. No go, said the Service. "The beneficiary designation form makes no mention of Trust T. Thus, we do not believe that Trust T can be said to be 'named as a beneficiary of the employee' as required." Moreover, to accept the court order "would, in effect, create or add designated beneficiaries by treating these individuals, including Taxpayer B, as designated beneficiaries even though they were not designated as such by Taxpayer A."

2. Because A died before his required beginning date, the five-year rule applied in making required minimum distributions.

C. Reformation of lousy beneficiary designation not recognized where sole purpose was to obtain tax benefit. Under the facts addressed in CCA 200848020, P's IRA named Trust, a testamentary trust created by P's will, as beneficiary. Trust, whose only asset was the IRA, provided that the trustee was to pay annually B% of the trust estate to each of P's six children, and C% to Charities. Slight problem(s): Trust had no termination date, and did not specify what was to happen if a child died during the trust's existence.

1. To address the problem, Trust was reformed and its terms modified by a state court. As reformed, Trust was to pay $ outright to Charities, and the remaining property was to be held in six separate shares as unitrusts, one for each child.

2. After discussing cases where commutation settlement payments to charities were or were not recognized for tax purposes, the Chief Counsel Advisory points out that "there was no conflict with respect to Trust…. [T]he purpose of the court order was not to resolve a conflict in the Trust; it was to obtain the tax benefits that would ensue if Trust were to qualify as a designated beneficiary trust under §401(a)(9) and the regulations thereunder…. Therefore, the accelerated payments to the four Charities are not considered to be made pursuant to the governing instrument, and Trust is not entitled to a deduction for such payments under §642(c)."

D. Disclaimers involving qualified plans and IRAs.

1. **This one worked**. In Ltr. Rul. 200839030, D named his wife W as beneficiary of his pension plan and an IRA, and as residuary beneficiary under his will. W disclaimed all of these interests, and as a result the interests passed under D's will to the couple's children. No problem with that, said the Service.

2. **But this one was an unmitigated disaster**. In Ltr. Rul. 200846003, a premarital agreement required D to create a QTIPable trust under her will, to be funded in part with an IRA. True to form, D's will created QTIPable Trust 1, providing for income at least quarter-annually to Spouse for life. Trust 1 is to terminate on Spouse's death, and the remainder is to pass to Trust 2, which benefits D's children. However, before her death D moved the IRA to an account that named her children as beneficiaries. After D's death, the children disclaimed their interests in the IRA. Under the IRA default beneficiary designation, the IRA passed to D's estate, where it was used to fund Trust 1.

a. **Not a qualified disclaimer, meaning a taxable gift**. Since, however, Trust 1 terminates in favor of Trust 2 and the children did not disclaim their interests in Trust 2, the children did not disclaim their entire interest in the IRA. Thus the children did not make a qualified disclaimer, with the result that the children have made a taxable gift.

b. … with the further result being loss of a marital deduction in D's estate. To qualify as a QTIPable trust, the IRA has to have passed from the decedent. Here, by reason of the nonqualified "disclaimers" the IRA passed to the trust from the children "and, accordingly, Decedent's estate is not entitled to a marital deduction for the Trust estate of Trust 1."

3. **Twenty-year-old's disclaimer takes care of his 17-year-old brother**. In Ltr. Rul. 200837046, P's IRA named her husband H as primary beneficiary and child B as alternate beneficiary. P and H were divorced, and an attorney prepared a new will for her. The attorney advised P to change the IRA beneficiary designation, but she didn't do so. Under state law, the beneficiary designation of H was revoked by reason of the divorce. This left B as the sole beneficiary under the IRA. P died survived by two children: B and C.

a. P left a will that created a trust for the benefit of B and C. The trust provided that if any portion of the trust consisted of distributions from an IRA, such portion as to be held in separate trusts, one for B and one for C. The trust for each child will terminate in the child's favor at age 36. B (age 20) disclaimed one-half of the IRA, and also disclaimed any rights (with respect to that one-half) under the will or by intestacy.

b. This will work, said the Service. The disclaimed interest will pass to the trust for the benefit of C, and each child will be treated as a designated beneficiary for purposes of required minimum distributions. (And, they might have added, you're a pretty nice brother.)

4. **No adverse tax consequences for disclaimer followed by reformation of will (!)**. In Ltr. Rul. 200850004, P's IRA named A as designated beneficiary and no alternate beneficiary. P's will made bequests to three charities, with no specification as to the funding source for the bequests. A disclaimed his interest in the IRA, which passed to P's estate as a result of the disclaimer. The estate obtained a local court order reforming the will, under which the IRA was designated as the source of the charities' shares of P's estate.

a. Section 691(a)(2) provides that if a right to an item of income in respect of a decedent is transferred by the estate of a decedent, the fair market value of the item is included in the estate's gross income. The term "transfer" includes sale, exchange or other disposition, but does not include transmission at death to the estate of the decedent or a transfer to a person pursuant to the right of such person to receive such amount by reason of the death of the decedent or by bequest, devise or inheritance from the decedent. The Service concluded that the assignment of the IRA from P's estate to the charities was not a transfer under §691(a)(2). As such, only the charities had to include distributions from the IRA in gross income.

b. Most courts have ruled that, while an irrevocable trust can be reformed to correct a mistake, a will cannot be reformed "after the testator's lips have been

sealed by death." See, *e.g*., *Jackson v. Templin*, 66 S.W.2d 666 (Tex. Comm. App. 1933).

5. **A pretty complicated beneficiary designation, but it all worked out**. In Ltr. Rul. 200843042, P's IRA named the participant's only child C as primary beneficiary and C's descendants as contingent beneficiaries. The beneficiary designation further provided that if a testamentary trust was established for the benefit of C under P's last will (*i.e*., if C survived P), the IRA was to be payable as a separate share to the testamentary trust. C survived P, and the testamentary trust was established. To eliminate estate tax in P's estate, C made a partial disclaimer. The disclaimed interest passed to P's spouse S (because C had no descendants), qualifying for the marital deduction.

   a. As for the undisclaimed interest, C is the sole income beneficiary of the trust which, after interim distributions of principal at designated ages, will terminate in C's favor when he attains age 40. If C dies before age 40, the trust passes to C's descendant or, if none, to P's heirs at law—who, if C died today, would be C's mother S. The ruling concludes that this is a valid "see-through" trust, and that S and C are the only individuals who need be considered potential designated beneficiaries. Accordingly, minimum distributions may be computed using S's remaining life expectancy, utilizing the single life expectancy table.

E. Compensatory damages treated as replacement payments. Under the facts of Ltr. Rul. 200850054, amounts paid to P as compensatory damages in an arbitration case against P's investment adviser were treated as replacement payments to P's IRA.

F. Waiver of 60-day rollover requirement. EGTRRA 2001 gave the Secretary authority to grant taxpayer relief in a number of situations (late allocation of GST exemption, reverse QTIP elections, etc.), including waiver of the 60-day rollover requirement for distributions from a qualified plan or IRA. Section 408(d)(3)(I) gives the Secretary authority to waive the 60-day rollover requirement "where the failure to waive such requirement would be against equity or good conscience, including casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement."

1. **When no private letter ruling is required—error by financial institution**. In Rev. Proc. 2003-16, 2003-1 C.B. 359, the Service set out the circumstances the Service would consider in deciding whether to grant a "hardship" waiver of the 60-day requirement. Additionally, the Service announced that it would automatically waive the 60-day rule for qualified plan and IRA rollovers if a financial institution's error caused the rollover to be untimely and several other conditions are met. The automatic waiver is granted if (i) the financial institution received the funds on behalf of the taxpayer prior to expiration of the 60-day period, (ii) the taxpayer followed all procedures required by the financial institution for depositing the funds in an eligible retirement plan within the 60-day period, (iii) solely due to the financial institution's error, the funds were not deposited in an eligible retirement plan within 60 days, (iv) the funds were actually deposited in an eligible retirement plan within one year from the beginning of the 60-day period, and (v) there would have been a valid rollover had the financial institution deposited the funds as instructed.

   a. The Revenue Procedure states that "[n]o application to the Service is required" if the above test is met. As is indicated by the number of private letter rulings listed below (and the list includes only ruling issued since August 2008), many

of which would appear to have qualified for automatic approval, the Revenue Procedure approach does not appear to have had its intended effect.

(1) This turns out to be working (or not working) much like the situation with respect to proposed modifications to grandfathered (pre-1985) GST trusts. The final GST regulations give some 20 examples in which automatic approval for certain modifications is given without the need for a ruling, and yet (as indicated later in this outline) the number of GST ruling requests appears not to have been stanched. Because the stakes are so high, and the cost of losing GST-grandfathered status is so great, more than a few taxpayers, and their advisors, have concluded that the peace of mind is worth the trouble and expense of securing a ruling.

(2) So also here, it appears. The cost of immediate income taxation, and losing the opportunity of tax-deferred build-up, would be substantial. A favorable letter ruling eliminates the nagging concern that, down the road, some IRS examiner may second-guess the taxpayer's determination that his case qualified for an automatic extension.

b. What is called for is the simplified procedure (no letter ruling required and no user fee charged) that is used for late allocation of QTIP exemption (Rev. Proc. 2004-46, 2004-31 I.R.B. 142) and requests for extension to make a reverse QTIP election (Rev. Proc. 2004-47, 2004-32 I.R.B. 169). Under these Revenue Procedures, in certain described cases the taxpayer simply sends a letter to Cincinnati, Ohio, describing the situation, and gets back a letter advising that the request has been granted.

2. **Problems with financial institution**. In all of the following rulings, and 60-day extension was granted to make the rollover.

a. **Financial institution placed funds in non-IRA account**. This is one of the most common errors. See 2008 series Ltr. Ruls. 32025, 35035, 47023, 50051 and 50056, 50053 and 52033, and See 2009 series rulings 02015, 04027, 04030, 04032, 04034, 07037, 07038, 07042, 07047, 07048, 09075, 09077, 11048, 14067, 14068, 24061, 25046, 26039, 26040, 27043, 29020, and 30080.

b. **Installment note for future distributions should have been rolled over.** In Ltr. Rul. 200846024, P received a plan distribution from a prior employer in five annual installments. P timely rolled over the first installment, but did not place the promissory note for the remaining four installments in an IRA. Two (two!) financial service firms advised P that he could roll over the subsequent payments when they were received.

c. **Funds mistakenly withdrawn from IRA account.** In Ltr. Rul. 200852032, P wanted a distribution to pay off a car loan to be made from a non-retirement brokerage account. The paperwork prepared by the account adviser instead requested a withdrawal from an IRA account.

d. **Excess required minimum distributions**. See 2008 series letter rulings 50055 and 52031 (distributions exceeded required minimum distributions) and 2009 series rulings 14069, and 12040 (firm advised P that no further action had to be taken with respect to excess distribution).

e. **"You're too old to make a rollover."** That's what an 88-year-old taxpayer was advised in Ltr. Rul. 200910068.

f. **Embezzlement precluded rollover**. In Ltr. Rul. 200826034, a waiver was granted where P's financial advisor misappropriated the rollover funds. Accord, 2009 series letter rulings 12042 (financial institution settled claims stemming from theft by firm's financial advisor) and 03104 (embezzlement by financial institution). The same pathetic facts were involved in Ltr. Ruls. 200922056-060.

g. **Financial advisor failed to establish new account on time**. In Ltr. Rul. 200847021, P intended that periodic payments from an IRA be deposited in a Roth IRA, but his financial adviser failed to prevent an automatic distribution until the account could be established. The distribution was then deposited in a non-IRA account.

h **Other problems**. See 2009 series letter rulings 13071 (financial officer advised surviving spouse that she had to make withdrawal of entire fund; no other options discussed), 12041 (plan failed to give proper written notice regarding rollover rules and tax consequences of distributions), 25043 (error by financial advisor), 26041 (financial institution made mistake in computing after-tax contributions).

3. **Warning to financial institutions**, financial advisors and professionals who give incorrect advice: The potential for substantial liability is very real. In the above cases, in which some bank or credit union employee or professional gave incorrect advice, who do you suppose paid (or should have paid) for the letter ruling request and the attendant costs? Far more serious, what is the potential liability if the request for an extension is denied?

    a. See Ltr. Rul. 200927043, where the funds were deposited in a non-IRA account. The taxpayer's documentation included a letter in which the bank president agreed to pay all fees associated with the filing of the ruling request.

4. **Medical and related problems**. A number of extensions have been granted where physical or mental problems of the participant or a family member got in the way of making a timely rollover. See 2008 series letter rulings 33030 (P's medical condition and death of his spouse; failure to timely rollover was discovered one after deadline passed), 34021 (impaired physical and mental condition), 47016, and 2009 series rulings 30051 (medical emergency), 26042 (H and W both suffered from various medical conditions), 29022 (P's wife who had mental problems made withdrawal from defined contribution plan), 27044 (medical problems), 25047 (health problems; bad advice from attorney), 24056 (life-threatening medical problems; taxpayer had since died), 24057 (husband who ran family finances seriously ill; daughter died in emergency room), 14070 (impaired mental condition), 13970 (mental problems), 11046 (mother had heart surgery in another state), 11047 (unexpected death of husband, who handled the couple's financial affairs), 10069 (taxpayer became ill and died during 60-day period), 09069, 07049, 06060 (mental state following death her spouse, and didn't know distributions were from IRAs), 04028 (mental condition), 04029 (mental condition), and 01035.

5. **Granddaughter murdered**. In Ltr. Rul. 200851043, P's failure to timely roll over was due to her mental anguish over the murder of her granddaughter.

6. **60th day fell on a Sunday**. The Service approved the rollover in Ltr. Rul. 200930052, where the taxpayer made the deposit on the following Monday, the 61st day.

7. **Extension denied**. Not all requests for an extension are successful.

   a. **How not to write the ruling request**. That may be one of the lessons from Ltr. Rul 200925048, where the ruling stated: "You have not presented evidence to the Service as to how any of the factors outlined in Revenue Procedure 2003-16 affected your inability to timely roll over Amount A or any portion thereof to an IRA. You have stated that, despite the progressive nature of your medical condition, you were physically able to visit your financial advisor in late ***; deposit the distribution check you received on Date 1 in your savings account; visit other financial advisors subsequent to the termination of your relationship with your original financial advisor at Financial Institution A; and visit a doctor on ***, to obtain a diagnosis of and treatment for your medical condition. Furthermore, you stated that your failure to timely rollover Amount A to an IRA within the required 60-day period could be attributed to your uncertainty over which financial advisor to trust, the state of the stock market in early 2008 and other reasons unrelated to your medical condition. Finally, you declined to respond to a request from the Service for additional documentary evidence supporting your assertion that your medical condition effectively prevented you from timely rolling over Amount A."

   b. **Withdrawal intended as short-term loan**. In Ltr. Rul. 200832026, P took a withdrawal from his IRA to secure short-term financing for the purchase of a trailer park. P represented that he intended to redeposit the money within the 60-day rollover period. He attempted to redeposit the money, but the IRA custodian refused to accept the deposit because the 60-day period had expired two days earlier.

      (1) P represented that his failure to make a timely redeposit was because he was preoccupied with his wife's medical condition. The Service was not persuaded. P's assertion that his wife's medical condition required his full time and attention was not supported by the fact that he (i) never intended to roll over the proceeds into another IRA, and (ii) used the proceeds as a short-term loan for a business purpose.

      (2) In Ltr. Rul. 200835036, P represented that he had planned to roll over the distributions and that the delay was due to his financial planner's failure to provide timely advice. We're not impressed, said the Service. The amounts distributed were used to purchase assets a new business, and P's ability to make a timely rollover was at all times within his control.

   c. **Financial institution had no duty to explain rollover rules**. In Ltr. Rul. 200847022, P claimed financial institution error in its failure to advise him of the rollover requirement. No go, said the Service. The Code imposes no obligation on IRA custodians to so advise account holders. Unless a financial institution undertakes such an obligation and gives erroneous advice, relief is not justified.

   d. **IRA and non-IRA funds commingled**. In Ltr. Rul. 200850057, P had rolled cver IRA funds to a new account but mistakenly also deposited non-IRA funds

in the same account, and then withdrew both deposits upon discovery of the error.

e. **Concern about identity theft** was the reason given by the taxpayer for IRA withdrawals in Ltr. Rul. 200904031. The problem was that she made no attempt to redeposit during the 60-day period.

f. **Other problems.** See 2009 series letter rulings 14071 (P took distribution despite financial adviser's explanation of tax consequences in both English and Spanish), 14072 (P was able to meet other financial obligations and fiancee's medical problems not at issue during relevant period), and 07049 (taxpayer thought he had 90 days).

IV. Section 671—Grantor Trust Rules

A. **Trust was grantor trust even though beneficiary held Section 678(a) withdrawal power over trust assets.** Ltr. Rul. 200840025 involved trusts that gave Crummey withdrawal powers to the beneficiaries. The ruling points out that the beneficiaries' withdrawal power ordinarily would make each beneficiary the "owner" of the trust for income tax purposes under §678(a). However, the grantor retained a §675(4) power to substitute assets of equivalent value, and the grantor trust rule trumped the §678(a) rule. As a result, the trusts were permitted shareholders in an S corporation.

1. Reaching the same result on similar facts, see Ltr. Rul. 200840025, where trusts were grantor trusts because a non-adverse trustee held the power to make loans to G without adequate security. (The power was subject to an off-switch: The non-adverse trustee could release this power by giving written notice to G and the current trust beneficiary.)

B. **Revenue Ruling: Grantor's exercise of substitution power exercisable in fiduciary capacity not a taxable gift and not a problem under estate tax**. In Ltr. Rul. 200842007, a trust created by G for the benefit of his wife and descendants gave G the power to substitute assets of equivalent value. The power was exercisable in a fiduciary capacity, meaning that the power had to be exercised in good faith and in the best interest of the beneficiaries. The Service ruled that G's exercise of the substitution power will not constitute a gift to the trust, and will not cause the trust property to be includible in G's gross estate on his death.

C. **Revenue Ruling: Grantor's substitution power in *nonfiduciary* capacity does not cause gross estate inclusion**. In Rev. Rul. 2008-22, 2008-16 I.R.B. 796, the Service ruled that a grantor's retained power, exercisable in a nonfiduciary capacity, to acquire property held in trust by substituting property of equivalent value will not, by itself, cause the value of the trust corpus to be includible in the grantor's gross estate. This result is subject to the proviso that the trustee has a fiduciary obligation (under local law or the trust instrument) to ensure the grantor's compliance with the terms of this power by satisfying itself that the properties acquired and substituted by the grantor are in fact of equivalent value. Also, the substitution power cannot be exercised in a manner that can shift benefits among the trust beneficiaries. This latter is not a concern, says the ruling, if either (a) the trustee has both the power (under local law or the trust instrument) to reinvest the trust corpus and a duty of impartiality with respect to the trust beneficiaries, or (b) the nature of the trust's investments or the level of income produced by any or all of the trust's investments does not impact the respective interests of the beneficiaries.

1. In the situation posited in the ruling, the grantor was not the trustee and was prohibited from serving as trustee. The ruling notes that in *Estate of Jordahl v. Commissioner*, 65 T.C. 92 (1975), acq. in result, 1977-2 C.B. 1, the court ruled that there was no gross estate inclusion where the grantor was the trustee. Here, under the terms of the trust the assets D transfers into the trust must be equivalent in value to the assets D receives in exchange. "In addition, T [the trustee] has a fiduciary obligation to ensure that the assets exchanged are of equivalent value. Thus, D cannot exercise the power to substitute assets in a manner that will reduce the value of the trust corpus or increase D's net worth. Further, in view of T's ability to reinvest the assets and T's duty of impartiality regarding the trust beneficiaries, T must prevent any shifting of benefits between or among the beneficiaries that could otherwise result from a substitution of property by D. Under these circumstances, D's retained power will not cause the value of the trust corpus to be included in D's gross estate under § 2036 or 2038."

V. Section 2002—Liability for Payment of Tax

A. **Executor's liability not discharged in bankruptcy**. So held in *Carroll v. United States*, 2009-2 U.S.T.C. ¶60,577 (N.D. Ala. 2009). The executors had elected installment payment of a $2.5 million estate tax liability under §6166, but six years later (with $1.4 million in estate taxes still unpaid) the executors distributed all of the estate assets to two closely held corporations. The two corporations ceased to operate, and one of the executors (decedent's son) filed for bankruptcy. The court ruled that although tax debts are generally dischargeable in bankruptcy, this was not the case here. Citing 11 U.S.C. 523(a)(1)(C) of the Bankruptcy Code, the son was personally aware that as executor he was personally responsible for payment of the tax, he actively transferred estate assets to the corporations for no consideration, and the transfers demonstrated an intentional disregard for the estate's tax liability.

VI. Section 2031—Definition of Gross Estate—Valuation Issues

A. **Do you have to use the term interest tables in valuing a lottery annuity? It depends on where you live.** If one of your clients hits the jackpot in the state lottery, you should advise the client to take the winnings in a lump sum and start spending (or gifting). If the winnings are taken in an annuity (typically, over 20 years), among the negative consequences is that the odds are increased that your client will die after receiving only a few annuity payments. This is strongly indicated by the "empirical evidence" of the number of estate tax cases involving just that scenario. The question then becomes: How should the remaining annuity payments be valued for estate tax purposes?

1. **Courts of Appeal are divided**. Should the discounted value of the remaining annuity payments be determined under the term interest tables, or should the tables be rejected because, due to restrictions on marketability, the tables do not accurately reflect fair market value? There is a split among the Courts of Appeal on this issue. The Second and Ninth Circuits have held that the tables should not be employed. *Estate of Gribauskas v. Commissioner*, 342 F.2d 85, 89 (2d Cir. 2003); *Shackleford v. United States*, 262 F.3d 1028 (9th Cir. 2001). The Fifth Circuit and a district court have held to the contrary. *Cook v. Commissioner*, 349 F.3d 850 (5th Cir. 2003); *Estate of Donovan v. United States*, 2005 WL 958403 (D. Mass. 2005).

2. **Sixth Circuit says "use the tables**." In *Estate of Negron v. United States*, 2009-1 U.S.T.C. ¶60,571 (6th Cir. 2009), the Court of Appeals for the Sixth Circuit, reversing the district court, held that the Service properly used its annuity tables to value a decedent's remaining lottery payments for estate tax purposes. The court concluded that departure from the tables was not justified or required.

a. In 1991 Mildred and Mary, along with a third party, won the Ohio Super Lotto jackpot of $20 million. Each was entitled to receive 26 annual payments of $256,410.26. Mildred and Mary both died in 2001, each having received only 11 lottery payments. The annuities were not assignable and could not be pledged as collateral. Negron, as executor for both estates, elected to receive a lump sum settlement of $2,275,867 for each estate, and reported that value on each estate tax return. The settlement was based on a 9 percent discount rate, using the state valuation tables in effect on the date the lottery prize was won.

b. The Service determined that the proper present values of the remaining lottery payments were $2,775,209 for Mildred and $2,668,118 for Mary. The Service used discount rates of 5 percent and 5.6 percent, based on the §7520 annuity tables in effect on the dates of death. The Court of Appeals for the Sixth Circuit agreed, concluding that non-marketability is an assumption underlying the §7520 tables, and that the tables did not produce an "unrealistic and unreasonable" valuation.

B. No summary judgment for government on valuation issue. In *Alan Baer Revocable Trust v. United States*, 2009-1 U.S.T.C. ¶60,573 (D. Neb. 2009), D's $62 million estate included interests in ComoreTel, a private equity company. The bulk of D's estate was left to a trust for which a QTIP election was made, but D's revocable trust provided that if D's interest in ComoreTel was sold during his wife's lifetime "and a profit realized, as determined in the sole and absolute discretion of Trustee," bequests totaling $1.35 million were to be paid to 23 individuals. Recognizing that the marital deduction had to be reduced, the estate reduced the amount of the deduction by $999,000, on the ground that the bequests should be discounted because (i) ComoreTel might never be sold, (ii) if it were sold it would likely be no sooner than six years, and (iii) it might not be sold as a profit.

1. While this predicate suggests that the issue to be resolved related to the marital deduction, the case actually turned on valuation issues. The estate contended that D's interest in ComoreTel was substantially less than an earlier appraisal had indicated, and that "the value attributed to the bequests is a 'phantom value' because the contingency—that ComoreTel stock is sold and a profit realized—cannot be fulfilled and the bequests cannot vest."

2. In this situation, summary judgment cannot be granted to the government, said the court. "The government's contention that value is irrelevant is misplaced. The Baer estate does not argue the contingent bequests are QTIPs, and should be part of the marital deduction. Rather, it seeks resolution of the factual issue of the date-of-death valuation of the ComoreTel stock. The Baer estate has presented evidence that the date-of-death value of the ComoreTel stock on which the deficiency determination relied was speculative and overstated…. With respect to determining the date-of-death value, evidence of post-death occurrences will be limited to evidence relevant to establishing the amount that a hypothetical willing buyer would have paid a hypothetical willing seller for the subject property as of the valuation date." Consequently, the value of D's interest was a fact issue that must be resolved at trial.

C. **Discounts, but not 100 percent discounts, recognized for built-in capital gains**. In *Estate of Litchfield v. Commissioner*, T.C. Memo 2009-21, D and a QTIP trust includible in her gross estate owned 43 percent interests in LRC (which primarily held farmland and related equipment and 23 percent interests in LSC (which primarily held securities and equity investments). The assets owned by both companies had significant unrealized capital gains. In a battle of dueling experts, the Tax Court was persuaded by the estate's valuation expert on all issues except marketability discounts. The court approved lack of control discounts of 14.8 percent for D's interest in LRC and 11.9 percent for D's interest in LSC, and lack of marketability discounts of 25 percent and 20 percent, respectively.

1. Both valuation experts agreed that substantial discounts should be recognized for built-in capital gains liability but, again, persuaded by the estate expert's report, the court recognized discounts of 17.4 percent with respect to LRC and 23.6 percent for LSC.

2. Interestingly (and as noted by the court in footnote 10), the estate did ask for a 100 percent dollar-for-dollar discount for the built-in capital gains, which was recognized in *Estate of Jelke v. Commissioner*, 507 F.3d 1317 (11th Cir. 2007), and *Estate of Dunn v. Commissioner*, 301 F.3d 339 (5th Cir. 2002). "Herein, the estate's expert does not assume that LRC's and LSC's appreciated, nonoperating assets would be sold on the valuation date, and the estate does not ask us to apply a full dollar-for-dollar valuation discount for estimated built-in capital gains taxes. Therefore, we need not decide herein whether such an approach would be appropriate in another case where that argument is made."

VII. Section 2033—Property In Which Decedent Had Interest

A. **They decided—after estate tax had been paid—that FLP had been formed and funded after all.** *Keller v. United States*, 2009 WL 2601611 (S.D. Tex. 2009), involving the estate of a prominent family in Victoria, Texas, was tried before the court in the "Southern District of Texas—Victoria Division." On June 26, 1998, H and W, both 88 years old, transferred $300,000,000 in cash, CDs and bonds to a revocable trust. "The family trust agreement did not provide for or attempt to dispose of the Williamses' considerable land and mineral holdings, all of which were dealt with separately." On H's death on January 5, 1999, the trust was divided into Share M (consisting of H's separate property and his one-half community property and Share A (consisting of W's separate property and her one-half community property). After H's death, W began discussion with Rayford Keller (the family's longtime CPA) and Rayford's son Lane "regarding various options for the protection and disposition of some of the assets held in Trust A and Trust M after her death." It was decided that an FLP should be created. Discussions continued during the summer of 1999, and in September Dallas attorney Sandy Bisignano was commissioned to draft the LP agreement.

1. Over the next several months, various revisions were made on the draft of the LP agreement, various flow sheets and notes reflected that the LP would be funded with $250 million of "Community Property Bonds, and work continued on the LP and general partner agreements. In March 2000, W was diagnosed with cancer. "This news, however, was tempered by the fact that her physicians did not believe, at that time, that her death was imminent." On May 9, 2000, final drafts of the agreements were brought to W in her hospital room and were carefully explained to her by Lane Keller. "After reviewing the Partnership Agreement one final time, Mrs. Williams signed the Agreement five times: once in her capacity as trustee of Share M, once in

her capacity as trustee of share A, once as president of the corporate general partner, and twice more in her capacities as trustee of Trust M and Trust A in approval and acceptance of her own signature as president of the corporate general partner. All executing signatures were notarized by Lane Keller."

2. "The last column of Schedule A is titled 'Initial Capital Contribution' and has a dollar sign next to three blank spaces for the amount to be contributed by each partner…. All of the blanks in the last column of Schedule A are empty…. The initial capital contributions that were to be inserted into these blanks are not otherwise discernable from anything located within the Partnership Agreement itself. Moreover, before Mrs. Williams' passing, no other Partnership documents existed, signed by the limited partners, indicating what the required contributions were to be or that the limited partners were required to make them.

    a. Why were the dollar amounts left blank? Because (Lane Keller testified) "I didn't have the firm market value of the [B]onds to be contributed to the partnership at that time," as fair market value would have to take into account accrued interest that had not yet been computed.

3. On May 10, Lane Keller applied for a Tax ID number and cut a $300,000 check payable to the corporate general partner (which was never signed by W). On May 11, Articles of Incorporation and a Certificate of Limited Partnership were filed with the Texas Secretary of State. The check was to be signed by W and further steps were to be taken after W was released from the hospital on May 15 as scheduled—but W died on May 15. No further actions regarding the partnership were taken for a year because W's advisors "did not feel that the Partnership had been properly formed or that they had an obligation to document the intended transfer of Bonds to the Partnership." On February 12, 2001, a check for $148.5 million was sent to the IRS along with a request for an extension to file.

4. **Let's hear it for those CLE seminars!** On May 17, 2001, Lane Keller attended an estate planning seminar in Victoria, at which one of the speaker discussed *Church v. United States*, 2000 WL 206374 (W.D. Tex. 2000), "which also dealt with an aborted family partnership, [giving] him some hope that his and the advisors' efforts with Mrs. Williams before her death had been successful after all, and that they had, in fact, formed and funded a viable family partnership…. Upon Lane Keller's notification, Mrs. Williams' advisors sprang into action and resumed their efforts with respect to formally establishing the Investment Partnership. These efforts included the formal recorded transfer of the Community Property Bonds to the Partnership." The estate tax return filed on August 14, 2001, reflected the value of partnership interests, and On November 15, 2001, the estate filed a refund claim for $40.5 million.

5. **… and the taxpayer won!** "Because Plaintiffs have established that Mrs. Williams intended to transfer the Community Property Bonds to the Partnership at the time she signed the Partnership Agreement, and that the Partnership was a valid Texas limited partnership before Mrs. Williams' death, the assets are considered partnership property before her passing, and Mrs. Williams' estate may be able to obtain a refund for taxes paid."

6. **The government is almost certain to appeal, but the trial court's findings of fact are really strong.** Mentioned below are some—but not all—of the key findings.

    a. "Of particular concern to Mrs. Williams as she worked to protect the family's interests was the risk of losing control of significant family assets through

divorces. She had been deeply troubled, for instance, by the divorce of her daughter … which was impliedly quite lengthy and expensive … and strengthened Mrs. Williams' resolve to prevent family assets from falling into the hands of former spouses and other non-blood relatives through divorce or any other means…. These efforts apparently paid off during other divorces, including that of another daughter."

b. "Mrs. Williams' health was declining during this period, but not failing. She was legally blind, but was credibly described as cogent and able to see well enough to read with some difficulty and to sign her name. She was further credibly described by Rayford Keller and Lane Keller as being sharp enough to discuss the details of her plans for the partnership in detail."

c. There was no basis for a §2036 implied-retention concern. W owned, outside the trust and the partnership, assets worth $110 million.

d. "It is clear to the Court that the primary purpose of these partnerships was to consolidate and protect family assets for management purposes and to make it easier for these assets to pass from generation to generation. Any estate tax savings that resulted from these partnerships were, in the Court's view, merely incidental. It is, therefore, clear to the Court that the primary purpose of these partnerships was not federal estate tax avoidance, and the actions taken to form these partnerships were not done so to create a disguise [sic] gift or shame transaction as those terms are used in estate taxation."

B. Reformation eliminates wholly extraneous "special needs" provisions. Ltr. Rul. 200918006 illustrates the importance of proofreading that will or trust before it leaves the office. G created irrevocable trusts for each or 10 grandchildren and great-grandchildren, with each beneficiary given a Crummey withdrawal power. Each trust was to terminate when the beneficiary attained age 40. However, the dispositive provisions contained "special needs" terms: The trustee had absolute discretion to distribute assets to a beneficiary, but barred the trustee from making distributions if the distributions would disqualify the beneficiary from receiving government benefits. G owned an undivided one-third interest in real property. Intending to stay within annual exclusions, G deeded x% of the entire property to three of the trusts, and notified the trustees that the transferred interests were valued at less than $10,000. Oops! That was supposed to be x% of G's one-third interest, not x% of the entire property! If left standing, the value of each of the transferred interests would exceed $10,000.

1. **Attorney eats humble pie**. How would you like to be the attorney who had to state in an affidavit that: (i) he erroneously included the "special needs" language; (ii) he did not discuss this language with G; (iii) this language is typically included in trusts drafted to allow an elderly trust beneficiary to continue government provided assistance; (iv) the language is inconsistent with G's intent; (v) none of the beneficiaries were elderly, were receiving, or were ever likely to receive any state assistance for support; and (vi) the title company refused to issue title policies because of defects in the three deeds?

2. After noting that state law permitted reformation of trusts and deeds based on mistake, the Service concluded that it would recognize the appropriate reformation of the trusts and the deeds, and that under the doctrine of relation back the deed reformations would be effective as of the date of the original deeds. There will be no inclusion in G's gross estate, and no inclusion in any of the beneficiaries' gross estates.

VIII. Sections 2036 and 2038—Retained Interests or Powers

A. Inept lawyering graphically described. "It is a truth universally acknowledged, that a single man in possession of a good fortune, must be in want of a wife." Some of you may recognize that as the opening line of Jane Austin's Pride and Prejudice. This was the obvious inspiration for the opening seintence of the court's opinion in *Estate of Hurford v. Commissioner*, T.C. Memo 2008-278, involving the widow of a former president of Hunt Oil Company: "It is a truth universally acknowledged, that a recently widowed woman in possession of a good fortune must be in want of an estate planner." That beginning reflects Judge Holmes' breezy and easily readable writing style, and I recommend reading the opinion, despite its length, for its entertainment value. (Entertaining, that is, if you find satisfaction in seeing a supposed estate planning attorney absolutely skewered for his ineptitude.)

1. The story began with H retaining Santo (Sandy) Bisignano, a highly regarded Dallas attorney, to plan the Hurfords' estates. Although Bisignano recommended some "slightly more aggressive techniques" including ILITs, GRATs and FLPs, H "took a conservative approach to estate planning," and the result was mirror wills for H and W, each with a bypass trust and a QTIPable trust. When H died in April 1999 survived by his wife Thelma and three children, his one-half of the $14.2 million community property estate passed into the bypass trust (tied to a $650,000 exemption equivalent) and the QTIP trust. The will named W as executor and trustee of the two trusts. Bisignano commenced to develop an estate plan for W, which began with gifts of $675,000 (the exemption equivalent in 2000) to the couple's three children. Developing the rest of a proposed plan took some time and was complicated by W's being diagnosed with cancer in January 2000 (nine months after her husband's death), and Bisignano was weighing the benefits of a full QTIP election versus a partial election that would produce a PTP credit under §2013 by paying some estate tax in H's estate.

   a. **How not to select an estate planning attorney**. The family got impatient with Bisignano. W was "concerned that he was not completing Gary's estate tax return or her own estate plan quickly enough and worried that he was too expensive…. Advice from Bisignano and KPMG was no longer free, because Hunt Oil stopped paying their bills after Gary died." One of the children started to look for a replacement attorney, "but living in Louisville made this mission difficult and he turned to his brother-in-law, an orthopedic surgeon living near Houston, for advice. This brother-in-law recommended Joe Garza."

   b. Two of the children "asked Garza to critique Bisignano's proposed estate plan and make suggestions on what he would do differently. Their infatuation with Garza was understandable. We observed Bisignano to be reserved and fastidious, and proud of the high quality of his work, but with a manner that on first appearance is perhaps not the most inviting. Garza, in contrast, is a model of the amiable and pleasing man; and his debut in the notes of Thelma's meetings with him show that she thought him one of the most agreeable men (or, at least, lawyers) that she had ever met." He also promised results. "We know from [daughter] Michelle's notes that Garza bragged that he had 'experience obtaining 50 percent discounts in settlements on estates with IRS, and also [he] had coached a lawyer in Mississippi in a valuation battle with IRS, and he got a 50 percent discount.'"

c. “According to Garza, a ‘brilliant estate-planning strategy’ is one ‘that saves estate tax.’ His plan was to separate Thelma's, the Marital Trust's, and the Family Trust's assets into three groups: (1) cash, stocks, and bonds; (2) Hunt Oil phantom stock; and (3) farm and ranch properties. He then created three FLPs, one to receive each group of assets, giving an interest in each to Thelma, Gary's estate, Michael, David, and Michelle. Finally, Garza directed Thelma to sell her and Gary's estate's interests in each FLP to Michael, David, and Michelle through a private annuity agreement.” (Yeah; a private annuity when the client has been diagnosed with cancer is a brilliant strategy!)

2. To say that the resulting plan was badly conceived and even more badly implemented would be an understatement—and Judge Holmes pulls no punches. A small sampling:

   a. The partnership agreements "show an unsteady drafting ability to even an untrained eye—a table of contents pointing to incorrect page numbers, a grant of a limited-partnership interest to the ‘Gary T. Hurford Trust’ when no such trust existed at the time, and signature pages showing HM-1 as the general partner of all three partnerships.”

   b. “Garza prepared another of his form letters to notify Hunt Oil that Thelma wanted the phantom stock moved to HI-2.” Richard Massman, Hunt's transfer agent and general counsel, received the letter on March 24, 2000, and quickly sent W a list of documents needed to approve the transfer: Letters testamentary, an excerpt from the will identifying W as beneficiary, documentation showing that the phantom stock was transferred from the estate to W, and an assignment from W to HI-2. One of the children got back to Massman *in October*—W had been diagnosed with cancer, remember—and Massman asked for an indemnity letter. “This prompted Garza to send Massman an indemnity letter on November 18, 2000, but this letter was as sloppy as the other paperwork he'd prepared, including a space on a signature line for ‘Daniel’ instead of David. Massman is a meticulous man, and he wanted the letter corrected. But it took Garza almost two months to fix his mistakes. The second letter satisfied Massman, though, and on January 15, 2001, Massman responded with his own letter stating that Hunt Oil recognized HI-2 as the owner of the phantom stock.”

   c. One of the LPs was to be funded with real estate. “To complete this chore, Garza prepared twenty deeds for Thelma to sign. Why twenty? We're not sure. We could not figure out by examining the deeds how eleven parcels (or fifteen, if a couple contiguous properties were divided) had multiplied into twenty. There was also another patent problem with the deeds. Garza had drafted each deed so that it conveyed the property to ‘Hurford No. 3, Ltd.’ not ‘Hurford Investments No. 3, LTD.’ Garza filed the deeds with the counties on March 23, 2000. But even twenty deeds were not enough: Garza failed to prepare a deed for a parcel that was in both Ellis and Dallas Counties. Garza waited until April 10, 2002, and then mistakenly deeded this parcel to ‘Hurford No. 3, Ltd.’, too.”

   d. In valuing HI-1 for purposes of computing the private annuity to be paid in exchange, Garza reported values for the stocks, bonds and mortgage notes. “We don't know where Garza got these numbers—while they are close to those on Gary's estate tax return, they differ by about $200,000. They are also significantly lower than the minimum of more than $5.5 million that the Hurfords agree was transferred into HI-1. And they in no way take into account

the changes in the composition of Gary's and Thelma's assets in the year after he died."

e. "In his April 4 letters, Garza valued the phantom stock at $5,552,377. That is the same value that he reported on Gary's estate tax return. It comes from a letter that Massman had sent Bisignano in May 1999 that included an estimated value for the phantom stock as of December 31, 1998. Garza testified that he used this value because it was the 'most current information that we had' and 'it didn't appear to me that the value was increasing very much.' But we know that the December 1998 value was already out-of-date because Hunt Oil recalculated phantom-stock values at the end of each calendar year. And we specifically find that the value of the phantom stock was increasing. In February 2000, Massman met with a Chase employee to discuss the phantom-stock plan and during that meeting he estimated that the phantom stock was already worth $6.4 million."

f. "In his April 4 letters, Garza listed the value of HI-3 as $2,020,800. This was again based on the same valuation used to report real estate values on Gary's estate tax return. But using the number from the return was wrong. Those real-estate values came from an appraisal that Bisignano had prepared and reflect the properties' values on April 12, 1999, the day Gary died, and Garza made no effort to consider any change in their values in the year that had passed. The $2,020,800 reported on Gary's estate tax return also included the Arlington and Tyler houses, and the Ellis/Dallas county property, none of which was actually transferred to HI-3."

g. "The method that Garza used to pick the discount factors to apply to the FLP interests was similarly haphazard. [H]e contacted several valuation appraisers [but] the appraisals were never done. Garza chose instead to use his own discount percentages, but even the precise percentages that he chose are unclear from the record. They fell, more likely than not, within the range bounded by the two versions of his April 4 letter."

h. A marital deduction of $6.54 million was taken on H's estate tax return. "The problem is that we have no idea which property is included in that number. On the schedule M it is only described as 'QTIP.' At trial, when asked about the number, Garza replied that he didn't remember how he computed it."

i. KPMG was replaced by another accounting firm, Turner & Stone. A K-1 for 2000 showed substantial capital contributions by the children. "These numbers appear to be complete fictions. We specifically find no evidence of money coming into or services provided for any of the FLPs or LLCs from the three Hurford children, much less the millions of dollars that Turner & Stone reported."

j. On the estate tax return signed by Garza as preparer, three of the No answers given to four questions were problematic. However, "Garza's answer of 'no' to the final question is just egregiously false. He himself had prepared Gary's estate tax return and should have known that section 2056(b)(7) refers to a QTIP trust like the one for which he claimed a deduction on that return."

3. **The private annuity**. In April 2000, two of the three children signed a private annuity agreement in exchange for W's transfer of LP interests. Why not Michael, the third child? He "has struggled with difficult personal problems, some of them severe, for much of his life." W wanted to benefit all three, so she received assurances from

the two other children that they would take care of Michael—laying the predicate for the government's successful contention that W retained a §2036(a)(2) power to retain beneficial enjoyment. In satisfying the $80,000 monthly annuity payments, the two children distributed back to W—guess what? The children did not have the resources to make the annuity payments, so they distributed assets that W had transferred to the FLP that contained marketable securities.

4. W died in February 2001. The estate tax return reported no taxable gifts, nor did it report a $240,000 refund claim that was shown on W's final income tax return (prepared by Turner & Stone). The Service assessed a deficiency. "Thelma's estate has conceded an increase in the estate's value of $3,381,999 because Garza failed to report the money Thelma received when she liquidated her IRA, her individual tax refund, and the proceeds from the sale of … stock. The estate also concedes that the true value of Thelma's THAA account was $426,206. The main issue that we are left to decide is what else should have been included—specifically, whether Thelma's transfers to the FLPs and the subsequent private-annuity transaction were valid under sections 2035, 2036 and 2038."

    a. Guess what? The court found for the government on every issue—with two exceptions. The government had challenged the $45,000 deduction for attorney's fees paid to Garza. Although there was no documentation to support this number, the court found that Garza had done some work for the estate and that $45,000 (out of the total of $300,000 he had received in fees) sounded about right. Also, the court declined to assert negligence penalties, concluding that these lay persons couldn't be expected to comprehend the ineptitude of the attorney and accountants who represented them.

B. Poorly implemented FLP leads to estate tax inclusion. In *Estate of Jorgensen v. Commissioner*, T.C. Memo 2009-66, involving a $797,000 deficiency, after her husband's death J transferred securities to an FLP. This was on the advice of the family estate planning attorney who advised that "hopefully your limited partnership interest in JMA partnership will qualify for the 35% discount…. Obviously, no one can guarantee that the IRS will agree to a discount of 35%, however, even if IRS agreed to only a discount of 15%, the savings to your children would be $145,066.00, and there can be no discount if the securities owned by you continue to be held directly by you." The attorney never personally met with J. Instead, all of the planning discussions relating to the LP were with Son, Daughter and Son-in-Law, none of whom made contributions to the LP. Son and Daughter were named general partners. J then made gifts of LP units to children and grandchildren in excess of annual exclusions; no gift tax returns were filed.

1. At one point, Son asked attorney whether there was a way "to access some of this money that's mine." The attorney explained that Son could take a loan, but Son "was surprised that he would have to pay interest." Son testified that "it took a while to get my head around the fact that it wasn't just like a bank account you can get money out of." Loans totaling $133,000 were made, and Son paid interest. (The loans were repaid after J's death.)

2. Although J kept sufficient funds to cover her daily expenses, she accessed the LP from time to time. The partnership agreement stated that withdrawals could be made only by general partners, but J was authorized to write checks on the LP checking account. She did so on a number of occasions, making gifts (not reported on returns) and quarterly income tax payments.

3. Guess what? The Tax Court held that transfers to the FLPs were not bona fide sales because (1) there was no legitimate nontax purpose for forming the FLPs and the purported nontax reasons were found to be insignificant; (2) the transactions were not at arm's length; and (3) the partners failed to follow any partnership formalities, such as maintaining sufficient records and treating the FLPs as separate entities. Also, the record reflected an implied agreement that J would retain economic benefits in the property.

4. **But children and grandchildren entitled to equitable recoupment for income taxes paid.** After J's death, her children and grandchildren paid capital gains tax on the sale of certain partnership assets. The court concluded that as a result of the gross estate inclusion, the estate was entitled to equitable recoupment for the overpayment of income taxes paid by the partners on their FLP interests. The doctrine of equitable recoupment applied because (1) the taxpayers were barred by the statute of limitations from recovering the overpayment, (2) the stock included in the gross estate and the stock sold by the partnership were the same items; (3) the estate tax and the income tax were both imposed on the same assets inconsistently; and (4) there was a sufficient identity of interest between J's estate and her descendants.

C. But this FLP (partially) upheld even though it held nothing but marketable securities. In *Estate of Miller v. Commissioner*, T.C. Memo 2009-119, D's husband retired from his architecture business at age 60. "From retirement to his death at age 86 in 2000, Mr. Miller devoted his time to researching and investing in securities. Mr. Miller spent significant time managing his family's investments and employed a specific investment methodology—charting stocks. Charting stocks involved the purchase and sale of securities on the basis of an analysis of their daily high and low values. Mr. Miller kept handwritten records of his investment activity." His investment strategy was quite successful: On Mr. Miller's death his QTIPable revocable trust (of which son Virgil was trustee) that was funded with assets valued at $7.6 million. After Mr. Miller's death, D executed various estate planning strategies: an irrevocable life insurance trust, a charitable annuity, and annual gifts to her descendants. In April 2002, 86-year-old D funded an FLP (of which Virgil was general partner) with marketable securities with a net value of $3.8 million.

1. The partnership agreement provided that its purpose was "to buy, sell, and trade in securities of any nature, including short sales, on margin, and for such purposes may maintain and operate margin account with brokers." Virgil "worked about 40 hours per week managing MFLP's assets. Mr. Miller had taught Virgil G. how to chart stocks, and Virgil G. managed MFLP's assets according to this philosophy. Virgil G. began managing the securities shortly after decedent's first transfers to MFLP in April 2002. Virgil G. subscribed to trade publications and purchased computer software to assist him in researching securities and carrying out MFLP's securities trading."

2. In April 2003, D fell and broke her hip. While in the hospital, doctors discovered that she needed heart surgery. A pacemaker was implanted on April 28, and on April 30 orthopedic surgery was performed on her hip. While in and out of the hospital she filled out code status forms which indicated that if she experienced any sort of acute medical episode, all measures possible were to be undertaken to return her to consciousness and health. On May 19, a traumatic brain injury was diagnosed, and her code status was changed to "comfort measures only." During the several weeks after D broke her hip but before the brain injury was diagnosed, D transferred securities in excess of $1 million to the FLP.

3. The court concluded that the April 2002 transfers to the FLP constituted bona fide sales for adequate and full consideration, and thus §2036 did not apply. D had

legitimate and substantial nontax business reasons for forming the FLP and for contributing the securities. "We find credible the witnesses' testimony that the driving force behind decedent's desire to form MFLP was to continue the management of family assets in accordance with Mr. Miller's investment strategy…. MFLP did not hold investments passively, collecting dividends and interest."

a. "Respondent's contentions concerning decedent's age are likewise misplaced…. At the time of the April 2002 transfers, decedent, although dealing with some chronic conditions, was generally in good health. Neither decedent nor her family expected any significant decline in decedent's health in the near future."

3. The court found, however, that D did not have a significant nontax purpose in making the May 2003 transfers. "The record indicates that the driving force behind the May 2003 transfers was the precipitous decline in decedent's health in the weeks before the transfers…. Although decedent was generally in good health before the April 2002 transfers, this was not the case in May 2003. In addition to breaking her hip, decedent had just undergone pacemaker implantation surgery. Further, decedent's rehabilitation was not progressing, and she was forced to return to the hospital with congestive heart failure."

a. As a consequence, §2036 applied. D, having transferred virtually all of her remaining assets to the FLP, had retained the economic benefits of the transferred property. "The May 2003 transfers were driven by Virgil G.'s desire to decrease the value of decedent's taxable estate. After this contribution, decedent did not retain sufficient assets to satisfy her estate tax liabilities…. Accordingly, the securities transferred are not entitled to the claimed discount and must be included in the value of decedent's gross estate at their fair market value."

IX. Section 2041—General Powers of Appointment

A. **Trustee' power limited by ascertainable standard despite language of "comfort" in spendthrift clause.** In Ltr. Rul. (T.A.M.) 200847015, the will of S's husband gave S as trustee the power to appoint principal in her "sole discretion reasonably exercised [as she] deems necessary and appropriate to provide for [her] health, support and maintenance ... in the manner to which she is accustomed." Also, S could, if she determined that the income was not sufficient, in her "sole discretion" distribute principal to "maintain and support [herself] in the station in life to which she is accustomed." That's ascertainable standard language, so what's the problem?

1. The trust's spendthrift clause, after the usual proscriptions on voluntary or involuntary transfer, provided: "Whenever and as often as the Trustee deems it appropriate so to do, in order to carry out the spirit and purpose of this provision, payment to any beneficiary named herein may be discontinued, and in lieu thereof, the Trustee may expend for the account of such beneficiary and for his or her support, comfort, happiness and welfare, such amounts as would otherwise be paid over directly to such beneficiary."

2. **Oops! Comfort, happiness *and* welfare?** Those are bad words! But there's no problem here, said the National Office. "[T]his power to discontinue payments and distribute trust property based on the broader standard of comfort and happiness, is exercisable by the trustee 'in order to carry out the spirit and purpose of this

provision,' that is the spendthrift provision contained in the first part of the paragraph. Thus, we believe this broad distributive power becomes exercisable only if the beneficiary triggers the spendthrift provision, for example, by attempting to assign the trust interest or if a third party attempts to garnish or execute against the trust interest, or the beneficiary otherwise becomes financially distressed in some manner. There is no indication that, at the time of [S]'s death, she met any criteria that would trigger the spendthrift provision and the ability to exercise the power."

B. **Pre-1942 power was not a general power of appointment.** Ltr. Rul. 200832015 involved pre-1942 trusts that gave beneficiaries testamentary powers of appointment, "provided however, that such appointees are 'members of the family'," defined to include "the husband or wife, as the case may be, and the children or other descendents of said person, and the children of Grantor and their descendents, but no other persons." Grandchild C is the beneficiary of one of the trusts and—oops! C is a descendant of Grantor! Does this mean that C can appoint trust principal to himself?

1. No problem, said the Service. This is a testamentary trust, meaning that C cannot appoint to himself or his creditors during his lifetime. Because the testamentary power permits appointment to a permissible class of appointees, C cannot appoint to his estate or the creditors of his estate. As a consequence, there will be no adverse estate tax consequences even if C exercises the pre-1942 power.

X. Section 2053 — Administration Expense Deduction

A. **Homestead held in revocable trust exempt from creditors' claims**. The two states with the most generous homestead laws are Florida and Texas. In Florida, a homestead (1/2 acre if within a municipality, 160 acres if not) and Texas (10 acres if urban, 200 acres if rural), is wholly exempt from creditors' claims without regard to the value of the improvements thereon. (There are various exceptions in each state, most notably with respect to a purchase money mortgage.) For a time, there was a question whether transfer of the homestead to a revocable trust loses creditor protection, as legal title must be conveyed to the trustee. Courts in both states have ruled that homestead protection is not lost by such an arrangement. *In re Alexander*, 346 B.R. 546 (Bankr. M.D. Fla.2007) and *Milligan v. Basedow, A-06-CA-242-LY* (W.D. Tex. 2006) (unpublished) both held that where a debtor opted for state law exemptions in a bankruptcy proceeding, transfer of his homestead to a revocable trust did not result in the loss of creditor protection..

1. In Texas, we don't have to rely on an unpublished district court opinion anymore. Property Code § 41.0021, enacted in 2009, makes it clear that transfer of a homestead to a revocable trust does not result in the loss of creditor protection.

XI. Section 2055—Charitable Deduction

A. **Contribution in exchange for charitable annuity qualifies for deduction.** In Ltr. Rul. 200847014, the Service ruled that a taxpayer who purchased a charitable gift annuity was entitled to a deduction equal to the amount transferred to the charity less the present value of the annuity—even though the charity contemplated acquiring a commercial annuity to satisfy its obligation. The charitable remainder rules did not apply because the taxpayer did not retain an interest in the transferred property. The annuity was to be paid from the charity's general funds. Section 170(f)(10) denies a charitable deduction if the charity pays

premiums on a "personal benefit contract," defined in a manner that seems to include charitable annuities backed by a commercial annuity. The Service ruled, however, that this case met the exception under §170(f)(10)(D). The charity held all of the incidents of ownership under the commercial annuity contract, the charity was entitled to all payments under the contract, and the timing and amount of payments under the contract were substantially the same as under the charitable gift annuity.

B. **Restructuring of CRUT terms on divorce passes muster.** In Ltr. Rul. 200832021, H established a charitable remainder unitrust, with the unitrust amount payable to H for life. On H's death, the unitrust amount is payable to W for life, but only if W furnishes the funds for payment of any federal or state death taxes for which the trustee may be liable. On the death of the survivor of H and W, the remainder is to pass to Charity.

1. H and W were divorced, and they now seek approval of a settlement under which the unitrust is to be divided into two trusts. H is the initial non-charitable beneficiary of Trust A. As under the original trust, on H's death the unitrust amount is payable to W for life, but only if W furnishes the funds for payment of any federal or state death taxes for which the trustee may be liable. The significant feature is that and W is the initial non-charitable beneficiary of Trust B. On W's death the unitrust amount is payable to H for life, but only if H furnishes the funds for payment of any federal or state death taxes for which the trustee may be liable. There also were revisions as to designation of the charitable remainder beneficiaries.

2. There are no tax problems here, said the Service, as all of this was accomplished pursuant to a divorce settlement. There are no capital gain consequences due to §1041, and no gift tax consequences thanks to §2516.

C. **Transfer of income interest in pre-1969 charitable remainder trust qualified for deduction**. In Ltr. Rul. 200834013, H and W, residents of a community property state, established a trust prior to the effective date of the Tax Reform Act of 1969: income to H and W for their joint lives, then to the survivor for life, remainder to Charity. Although the trust was specifically stated to be irrevocable, H and W (or the survivor) reserved the right to amend the trust, subject to the restriction that nothing could be returned to the settlors or their issue and no amendment could revoke the distribution of the remainder interest to charities. H died, and W now proposes to transfer her income interest to the designated charitable beneficiaries. Under state law, the trust will terminate in favor of the charities. Although the trust has been amended, no additions to the trust have been made since the trust was created.

1. We've got no problem with that, said the Service. W's gift of her income interest will qualify for gift tax and income charitable deductions, and if W dies within three years (triggering §2035), her estate will qualify for a charitable deduction equal to the amount included in her gross estate.

D. **Service approves CRUT that gives special trustee discretion over portion of unitrust payments.** In Ltr. Rul. 200832017, G proposes to create a charitable remainder unitrust providing for payment of 25 percent of the unitrust amount to G for life, then to G's spouse S for life. A special trustee had the discretion to distribute the remaining 75 percent to G (and after her death to S) and/or any charitable organization. Upon the death of the survivor, the trust principal shall be distributed to Charity. However, G (and after her death S) has the power to name one or more new charitable remainder beneficiaries, as long as at least one charity receives at least one-third of the trust property. Also, G (and after her death S) has the power to remove and replace the special trustee, with the proviso that G, S

or a related or subordinate party cannot be named special trustee. The trust designates the initial special trustee and successor special trustee, and the special trustee can be replaced only by persons named in the trust agreement in the order they are named. When the trust is funded, the present value of the remainder interest will be at least ten percent of the value of the property contributed to the trust. G will be the initial trustee of the CRUT. G received a favorable ruling on all of the issues raised.

1. This is a valid charitable remainder unitrust. The ruling notes that ordinarily the Service will not issue rulings on whether a CRT qualifies, as taxpayers are supposed to follow the sample CRUT provisions set out in Rev. Proc. 2005-55, 2005-2 C.B. 367. Since, however, the proposed CRUT contains provisions not addressed in Rev. Proc. 2005-55, it will consider the ruling request.

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

3. The power retained by G (or S) to remove the special trustee and substitute another does not disqualify the trust.

4. Creation of the trust will not have gift tax consequences. The gift is incomplete as to the remainder interest because G has retained the power to remove and replace Charity as the remainderman. However, per Rev. Rul. 76-8, 1976-1 C.B. 179, retention of this power will not disqualify the trust.

5. The 25 percent remainder unitrust interest given to S will qualify for the marital deduction under §2523(g), as S is the only noncharitable beneficiary other than G. Also, on G's death the unitrust interest given to S will qualify for the marital deduction under §2056(b)(8).

E. **Settlement of charities' constructive sale claim supported additional charitable deduction**. In *Estate of Williams v. Commissioner*, T.C. Memo. 2009-5, D's will bequeathed her stock in Company to the issue of her father's business partner, and the rest of her estate to four charities. As the result of a merger between Company and Public Company, D's stock in Company could have been sold before her death. However, one of the noncharitable beneficiaries, acting under a power of attorney, gave Public Company an option to purchase Company's stock for a fixed price after D's death. The charities sued the noncharitable beneficiaries on theories of constructive sale of the stock and breach of fiduciary duty. The parties settled, and the estate claimed an additional charitable deduction for the lesser of the Company stock's value and the settlement amount.

1. The Tax Court upheld the additional charitable deduction, taking into account the charities' probable success in asserting the constructive sale claim.

F. **Cases involving non-qualifying split interest trusts continue to arise.** It has now been 40 years since Congress, in the Tax Reform Act of 1969, decreed that there can be no

charitable deduction under the income tax, gift tax or estate tax for a charitable remainder unless the noncharitable interest takes the form of an annuity or unitrust payout. And yet, sadly, each year brings a number of cases and rulings involving nonqualifying dispositions. Because of a continuing stream of cases involving nonqualifying dispositions, Congress enacted temporary—later, permanent—provisions authorizing reformation actions provided such actions were taken within a prescribed period.

1. **Having a "professional" executor didn't help**. In. *ESB Financial v. United States*, 2008-2 U.S.T.C. ¶60,567 (D. Kan. 2008), a trust provided for income to Daughter for life, remainder to Charity. On April 26, 2003 (the due date after an extension), ESB Financial filed the Form 706, taking a $325,000 charitable deduction. In early June, the Service advised that it was opening an examination of the estate tax return regarding the claimed deduction. In April 2004 (!), the executor filed a motion to retroactively modify the trust, and the state court granted the modification. Too late, said the court in granting summary judgment for the government. The reformation proceeding was commenced more than 90 days after the due date for the return.

2. **Service takes hard line on nonjudicial division of nonqualifying trust**. The trust codes of a number of states authorize the division of a trust into two or more separate trusts without a judicial proceeding. [*E.g.*, Tex. Ppty. Code §112.057.] The National Office has made it clear that this is not the procedure to follow in dealing with a non-qualifying split interest trust. In Ltr. Rul. (T.A.M.) 200840008, a testamentary trust provided for 25 percent of the income to, 25 percent to B, and the balance to be distributed to charities as selected by the trustee. The executors filed with the state attorney general a notice advising that, pursuant to the state's statute, they were going to divide the trust into two trusts, one for the noncharitable beneficiaries and the other for the charitable beneficiaries.

    a. Not good enough, said the Service. A charitable deduction will be allowed for a nonqualifying trust only if a judicial reformation action that meets the requirements of §2055(e)(3) is filed within the prescribed time. "Allowing the deduction under these circumstances would be contrary to the intent of Congress in enacting §2055(e)(3) and would render §2055(e)(3) superfluous."

3. **Qualified reformation was timely made.** Ltr. Rul. 200832003 involved a typical non-qualifying trust disposition: Income to Brother and Sister for life, remainder to Charity. The problem was solved by instituting a reformation action pursuant to §2055(e)(3) within 90 days after the last date (including extensions) for filing the estate tax return, with the reformation converting the trust into a unitrust.

    a. In Ltr. Rul. 20927023, two testamentary charitable remainder trusts were in proper annuity form but did not include certain provisions required by Reg. §§ 1.664-1 and 1.664-2. The Service gave its approval to reformations that would add the missing provisions.

G. Where there was no dispute, bona fide or otherwise, no income tax deduction for lump sum payment to charity pursuant to judicial modification. Under the facts of CCA 200848020, a trust whose sole asset was an IRA, provided for payment of a unitrust amount of a% as follows: b% to each of D's six children and c% to Charities. The trust had no termination date, and did not provide for the disposition of a child's share upon the child's death. Needless to say, the trust did not qualify as a designated beneficiary of the IRA. To "solve" the problem, the trust was reformed in a judicial proceeding. Under the court order, the trustee paid c% of the value of trust outright to Charities and divided the balance of the trust estate into separate shares for each of D's children, with each child

entitled of a% a year. The order further provided that each child's separate share is to be distributed outright to each child at a specified age. The purpose, of course, was to make the trust met a "designated beneficiary." The trust took an income tax charitable deduction for the lump sum distribution to Charities.

1. **Guess what? The Chief Counsel's office was not impressed**. The Chief Counsel's office concluded, not surprisingly, that the purpose of the modification was not due to conflict, but rather to obtain tax benefits. Therefore, the outright distribution to Charities was not made pursuant to the governing instrument, and a charitable deduction under § 642(c)(1) was not allowed.

2. The CCA discussed and applied *Crown Income Charitable Fund v. Commissioner*, 8 F.3d 571 (7th Cir. 1993) (payments to charities as result of commutation of trust's charitable interest were not made pursuant to governing instrument) and *Brownstone v. United States*, 465 F.3d 525 (2nd Cir. 2006) (beneficiary's exercise of general power of appointment in favor of charity did not give trust an income tax deduction).

H. Bequests to foreign municipality qualified for deduction. Ltr. Rul. 200905015 gave its blessing to charitable deductions for a bequest to a trust "to be used for charitable purposes" in a foreign municipality, and a bequest of paintings to a museum in the municipality.

XII. Section 2056—Marital Deduction

A. QTIP trustee did not have duty to transfer marketable securities to a family limited partnership. So ruled in *Matter of Galloway*, C5-05-200042 (Minn. 2d Dist., April 23, 2007), where the children sued the trustee, contending that it should have created an FLP to reduce the gross estate inclusion in the surviving spouse's estate. Noting that the reduction in value of the assets transferred to the FLP would have been greater than the reduction in estate tax liability, the court concluded that it would be difficult to create an FLP that would produce the desired valuation discounts while still satisfying the trustee's fiduciary duties.

B. Incorrect applicable exclusion amount employed; correction of error permitted. In Ltr. Rul. 200832011, the estate's attorney and executor intended to make a partial QTIP election with respect to the amount necessary to reduce the estate tax to zero. In computing that amount, however, the attorney applied the exclusion for the year the estate tax return was filed instead of the year in which D died.

1. Matters were helped by the fact that D's will provided: "I anticipate that the Executor will elect to treat some portion of the property in this trust as qualified terminable interest property that qualifies for the marital deduction in the determination of the federal estate tax liability imposed upon my estate. I recognize, however, that future tax considerations, whether relating to the time of my wife's death and mine, the availability of advantageous tax options for my estate, or otherwise, may indicate that it would be prudent not to make the election in whole or in part, and for this reason I leave the responsibility for that decision to the Executor." The Service recognized that an error had been made, and the estate tax was reduced to zero.

2. Reaching the same result, see Ltr. Rul. 200918014.

C. **Trust reformed—after testator's death—to make it QTIPable**. In Ltr. Rul. 200919003, after his first wife died D amended his revocable trust to omit an income interest in favor of his surviving spouse. Contemplating remarriage, D instructed Attorney to prepare an amendment reinserting a qualifying income interest. Attorney did so, and the amendment also gave the spouse a special power of appointment, The clause granting the limited power specified how the power was to be exercised, *i.e.*, by a will timely admitted to probate. However, the provision also stated that the power could be exercised "during lifetime or by Will."

1. Left standing, this would preclude a QTIP election, as during a spouse's lifetime no one, not even the spouse, can be given a power to appoint property to anyone other than the spouse. "Attorney had never discussed the possibility of a lifetime exercise with Decedent, and was unaware of the presence of the phrase 'during lifetime' [although he drafted the amendment!] until it was brought to his attention more than nine months after Decedent's death by a representative of one of Decedent's beneficiaries." The Service ruled that it would give credence to a reformation removing the "during lifetime" phrase, making the trust QTIPable.

2. I wonder who paid for the ruling request and the reformation action.

D. **"Pay all taxes *from* the trust" before marital gift funded did not override Utah's estate tax apportionment statute**. So held in *Estate of McCoy v. Commissioner*, T.C. Memo 2009-61, involving a $412,000 deficiency. D's 1994 will made a pourover gift to a revocable trust that made gifts to his children, grandchildren, and his then-wife Roxanne. The trust, also executed in 1994, provided that if D was survived by his wife, estate taxes, debts and expenses were to be charged against the nonmarital share of the trust. D divorced Roxanne, married Michele, and in 1999 executed a "restated trust agreement." This version of the trust provided that "[t]he Trustee shall pay from the residue of the trust estate prior to any distributions provided for herein, [debts and expenses], and shall pay all estate taxes, if any, attributable to Settlor's entire taxable estate."

1. The Tax Court found an ambiguity. "[I]t is not clear whether decedent intended these provisions to govern the allocation of the taxes at all or whether he merely intended them to be the source of the estate tax payments. The restated trust agreement states that "The Trustee shall pay *from* the residue of the trust estate prior to any distributions provided for herein, * * * all estate taxes, if any, attributable to Settlor's entire taxable estate." (Emphasis added.) While decedent may have intended the word 'from' to indicate that the taxes were to be both charged to and paid out of the residue, this intention is not as clear as the statement in the original trust agreement…. While it is possible that, as respondent argues, decedent intended for the residue of the trust estate to both be the source of the estate tax payment and bear the burden of the estate tax, we find that this intent is not clear."

2. The court noted that in *Estate of Huffaker*, 641 P.2d 120 (Utah 1982), the Utah Supreme Court expressed "a strong policy in favor of the equitable allocation of the tax burden provided in the statute prescribing apportionment, and … a direction to the contrary in a will or other dispositive instrument must be expressed in terms that are specific, clear, and not susceptible of reasonable contrary interpretation." The cases from other states cited (and implicitly approved by the Utah court) directed that "any ambiguity as to how the estate taxes are to be apportioned should be resolved in favor of apportionment." As a consequence, the apportionment statute applied, meaning that taxes were to be charged against the nonmarital share.

3. The opinion in *Estate of McCoy v. Commissioner* is useful in its citation to and discussion of cases from a number of other states, some of which have been as generous as this court in finding that the particular language at issue did not override the state's apportionment statute.

E. **QTIP property includible in spouse's gross estate even though she never received trust income**. In *Estate of Miller v. Commissioner*, T.C. Memo 2009-119, an FLP case discussed under §2036, a QTIP election was made for a revocable trust established by D's husband (valued at $7.6 million on his death). Although the trust provided for distribution of all income to D at least annually, in the three years in which D survived her husband no distributions of income were made. All trust income was reported on the trust's Form 1041.

1. The estate contended that the QTIP trust should not be includible in D's gross estate because she never received distributions from the trust, never needed the income, and that she should be treated as having disposed of her trust interest during her lifetime. The Tax Court was not impressed. The gross estate inclusion was the price of having secured a marital deduction in the husband's estate.

F. **Extention to make QDOT election.** In Ltr. Rul. 200842018, the Service granted an extension of time to make a qualified domestic trust election and to assign property to the QDOT. The estate's accountant assumed that property passing to the spouse, a lawful permanent resident, qualified for the marital deduction under § 2056(a). Accord, Ltr. Rul. 200910019.

XIII. Section 2503—Taxable Gifts

A. **No annual exclusions where power of attorney did not authorize the making of gifts**. So held in *Barnett v. United States*, 2009-2 U.S.T.C. ¶60,576 (W.D. Pa. 2009). Between July 31 and October 13, 2003 (the latter being the date of D's death), D's son made and delivered 17 gift checks of $11,000 each. No go, said the court; the $187,000 is includible in D's gross estate. Under Pennsylvania law, gifts can be made by an agent under a power of attorney only if the power expressly authorizes the making of gifts.

XIV. Section 2511—Gift Tax Transfers in General

A. **Gifts of interests in single-member LLC treated as gifts of interests in the entity (subject to discounts), the "check-the-box" regulations notwithstanding.** In *Pierre v. Commissioner*, 133 T.C. No. 2 (2009), P "received a $10 million cash gift from a wealthy friend in 2000." In July 2000, P created a single-member LLC under New York law. "Petitioner did not elect to treat Pierre LLC as a corporation for Federal tax purposes by filing a Form 8832, Entity Classification Election, and therefore filed no corporate return for Pierre LLC." On September 15, 2000, P transferred $4.25 million in cash and securities to the LLC. On September 27 (12 days later), P transferred 9.5 percent of her interest in the LLC to trusts for the benefit of her son and granddaughter (utilizing her estate tax exemption equivalent and GST exemption), and on the same day sold each trust a 40.5 percent interest in exchange for a secured promissory note. In valuing the gifted 9.5 percent interest, P took a 36.55 discount (which P admitted should have been 30 percent because of a computational accounting error).

1. The Service determined a deficiency, taking the position that the gifts should be valued as transfers of proportionate shares of the underlying assets, rather than as transfers of interests in the LLC. The government must have thought it had a winning argument, because §301.7701-1(a)(1) of the "check-the-box" regulations provides: "The Internal Revenue Code prescribes the classification of various organizations for federal tax purposes. Whether an organization is an entity separate from its owners *for federal tax purposes* is a matter of federal tax law and does not depend on whether the organization is recognized as an entity under local law. [Court's emphasis.] The court went on to note, however, that §§ 301.7701-3(a) and (b) provides: "*Classification* of certain business entities.-(a) * * * A business entity * * * can elect its *classification* for federal tax purposes as provided in this section. An eligible entity * * * with a single owner can elect to be *classified* as an association or to be disregarded as an entity separate from its owner. Paragraph (b) of this section provides a default classification for an eligible entity that does not make an election. [Court's emphasis.]"

2. In a 10-6 decision, the Tax Court concluded that "[w]hile we accept that the check-the-box regulations govern how a *single-member LLC* will be taxed for Federal tax purposes, *i.e.*, as an association taxed as a corporation or as a disregarded entity, we do not agree that the check-the-box regulations apply to disregard the LLC in determining how a *donor* must be taxed under the Federal gift tax provisions on a transfer of an ownership interest in the LLC. If the check-the-box regulations are interpreted and applied as respondent contends, they go far beyond *classifying* the LLC for tax purposes. The regulations would require that Federal law, not State law, apply to define the property rights and interests transferred by a donor for valuation purposes under the Federal gift tax regime. We do not accept that the check-the-box regulations apply to define the property interest that is transferred for such purposes." [Court's emphasis.]

    a. The court noted that the Special Valuation rules of §§ 2701-2704 were "designed to override the standard 'willing buyer, willing seller' assumptions in certain transactions involving family members…. By contrast, Congress has not acted to eliminate entity-related discounts in the case of LLCs or other entities generally or in the case of a single-member LLC specifically. In the absence of such explicit congressional action and in the light of the prohibition in section 7701, the Commissioner cannot by regulation overrule the historical Federal gift tax valuation regime contained in the Internal Revenue Code and substantial and well-established precedent in the Supreme Court, the Courts of Appeals, and this Court, and we reject respondent's position in the instant case advocating an interpretation that would do so."

3. The court's opinion begins with a footnote: "The Chief Judge reassigned this case for Opinion and decision to Judge Thomas B. Wells from Judge Diane L. Kroupa, who presided over the trial. Judge Kroupa does not disagree with our fact findings as they relate to the legal issue addressed in this Opinion." What likely happened was that Judge Kroupa wrote an opinion, presumably intended to be a T.C. Memo. decision, which, upon circulation among the judges, produced objections. Not surprisingly, Judge Kroupa ended up authoring one of two dissenting opinions.

4. **But other issues will be addressed by the court in a later opinion**. In footnote 3, Judge Wells noted that "[i]n this Opinion, we decide only the [check-the-box] issue…. The following issues were argued by the parties but will be addressed in a separate opinion: (1) Whether the step transaction doctrine applies to collapse the separate transfers to the trusts and (2) the appropriate valuation discount, if any."

B. **No indirect gift where gift of LP interests made six days after FLP was funded**. In *Holman v. Commissioner*, 130 T.C. No. 12 (2008), the Tax Court ruled that no indirect gift occurred where substantial gifts of LP interests were made six days after a family limited partnership was established and funded. In another important aspect of the decision, the court held that §2703 ("Certain Rights and Restrictions Disregarded") applied to transferability restrictions in the partnership agreement, precluding a discount for such restrictions.

1. **The facts**. H worked for Dell Computer Corp. from 1988 to November 2001, and had acquired substantial holdings of Dell stock and stock options. In 1997, the family moved from Texas to Minnesota, where over several years H and W obtained estate planning advice from a Minneapolis attorney. On November 2, 1999, H and W created an irrevocable trust for their issue (they had four minor children), naming H's mother M as trustee. On that same day, H, W and the trust joined in the creation of a family limited partnership, with H and W contributing 70,000 shares of Dell stock and M as trustee contributing 100 shares. In exchange, H and W each received 0.89 percent general partner interests and 49.04 percent limited partnership interests. The trust received a 0.14 percent LP interest. Six days later, on November 8, H and W made gifts of 70.06 percent of the LP interests to the trust and a smaller gift to a UTMA custodianship for their youngest daughter (to make up for earlier UTMA gifts to the three older daughters). H and W made annual exclusion gifts of LP units on January 4, 2000, contributed additional shares of Dell stock in exchange for LP units in January 2002, and made annual exclusion gifts of LP units in February 2001. On all three gift tax returns, H and W took discounts of 49.25 percent. After these transactions, H and W each held 0.56 percent general partner interests and 5.04 percent limited partner interests, the trust held 44.29 percent of the LP units, and each of four UTMA custodianships held 11.13 percent of the LP units.

   a. The court found that H and W had plans to make the gifts of LP units at the time the partnership was created. During the relevant period (1999-2001), the FLP owned nothing but Dell stock. When the FLP was established, H had no immediate plan other than that it would hold the Dell shares. The partnership had no business plan, no employees, no telephone listing in any directory, and prepared no annual statements. The partnership had no income to report, and it filed no federal income tax return for any of the three years.

   b. **The government's contentions**. The Service assessed gift tax deficiencies of $230,000, challenging the taxpayers' valuation of the gifted interests and the discounts taken thereon. The government made two "indirect gift" arguments: that the transactions should be treated as gifts of the Dell stock itself and not LP interests or, alternatively, that the step transaction doctrine should be applied. The government also contended (successfully, it turned out) that §2703 applied to preclude discounts for restrictions on transferability contained in the partnership agreement. The government abandoned two arguments it initially made: that gifts to the partnership should be treated as gifts to a trust, and that under §2704(b) restrictions on liquidation should be disregarded.

2. **Gift to partnership not indirect gift to partners**. The government contended that the transfer of assets to the FLP was in substance an indirect gift to the partners, just as a gift by a shareholder to a corporation is a gift to the other shareholders. The government relied on *Shepherd v. Commissioner*, 115 T.C. 376, 283 F.3d 1258 (11th Cir. 2002), and *Senda v. Commissioner*, T.C. Memo. 2004-160, affd. 433 F.3d 1044

(8th Cir. 2006), "in both of which we concluded that transfers by a partner to a partnership were indirect transfers to the other partners."

a. In *Shepherd*, S transferred property and shares of stock to a newly formed FLP in which he was a 50-percent owner and his two sons were each 25-percent owners. Rather than allocating contributions to the capital account of the contributing partner, under the partnership agreement the contributions were allocated pro rata to the capital accounts of each partner. Because the values of the noncontributing partners' interests were enhanced by S's contributions, "we held that the transfers to the partnership were indirect gifts by the taxpayer to his sons of undivided 25-percent interests." In *Senda*, S's transfers to the partnership and the transfers of LP interests occurred on the same day.

b. The facts in this case are distinguishable, said the court. When the transfers were made to the FLP, the contributing partners received partnership interests proportional to what they had contributed, and the gifts occurred six days later. "Petitioners did not first transfer LP units to [M as trustee and UTMA custodian] and then transfer Dell shares to the partnership, nor did they simultaneously transfer Dell shares to the partnership and LP units to [M]. The facts of the *Shepherd* and *Senda* cases are materially different from those of the instant case, and we cannot rely on those cases to find that petitioners made an indirect gift."

3. **No indirect gift under the step transaction doctrine**. The government alternatively argued that H and W made an indirect gift under the step transaction doctrine. "The nub of respondent's argument is that petitioners' formation and funding of the partnership should be treated as occurring simultaneously with their 1999 gift of LP units since the events were interdependent and the separation in time between the first two steps (formation and funding) and the third (the gift) served no purpose other than to avoid making an indirect gift…. While we have no doubt that H and W's purposes in forming the partnership included making gifts of LP units indirectly to the children, we cannot say that the legal relations created by the partnership agreement would have been fruitless had petitioners not also made the 1999 gift. Indeed, respondent does not ask that we consider either the 2000 gift (made approximately 2 months after formation of the partnership) or the 2001 gift (made approximately 15 months after formation of the partnership) to be indirect gifts of Dell shares."

a. *Senda v. Commissioner*, on which the government relied, was distinguishable because in that case the gifts were made on the same day the partnership was formed. Here, the gifts occurred almost a week later. Moreover, H and W "bore the risk that the value of an LP unit could change between the time they formed and funded the partnership and the times they chose to transfer LP units…. Respondent apparently concedes that a 2-month separation is sufficient to give independent significance to the funding of the partnership and a subsequent gift of LP units. We assume that concession to be on account of respondent's recognition of the economic risk of a change in value of the partnership that petitioners bore by delaying the 2000 gift for 2 months. We draw no bright lines."

b. "[W]e shall treat the 1999 gift the same way respondent concedes the 2000 and 2001 gifts are to be treated; *i.e.*, we shall not disregard the passage of time and treat the formation and funding of the partnership and the subsequent gifts as occurring simultaneously under the step transaction doctrine."

c. In a footnote, the court observed that "[t]he real economic risk of a change in value arises from the nature of the Dell stock as a heavily traded, relatively volatile common stock. We might view the impact of a 6-day hiatus differently in the case of another type of investment; *e.g*., a preferred stock or a long-term Government bond."

4. **Section 2703 applied to transfer restrictions**. Although buy-sell agreements are not mentioned in §2703, the legislative history makes it clear that the primary thrust of the statute is to tighten the rules as to when a buy-sell agreement or similar arrangement is binding for transfer tax valuation purposes. Unless a three-prong statutory test is satisfied, the value of property is to be determined without regard to any option, agreement, or other right to acquire the property at less than fair market value, and without regard to any restriction on the right to sell or use the property. An agreement will be recognized for valuation purposes only if (1) it is a bona fide business arrangement, (2) it is not a device to transfer property to family members for less than full and adequate consideration, and (3) its terms are comparable to similar arrangements arrived at in arms length transactions. In *Holman*, the court ruled that §2703 applied to the FLP's transferability restrictions, and concluded that the restrictions failed tests (1) and (2).

a. **Restrictions on transferability were similar to those found in many FLPs**. The partnership agreement prohibited transfers of LP interests with the written consent of all the partners, permitted transfers to other family members, and provided (in paragraph 9.3) that if a transfer to a non-family member nonetheless occurred the partnership had the option to purchase the assignee's interest. As the taxpayers' expert witness testified, these provisions "are comparable to provisions one most often finds in limited partnership agreements."

b. **No business purpose**. The court noted that in *Estate of Amlie v. Commissioner*, T.C. Memo. 2006-76, it had held that the subject of a restrictive agreement need not directly involve an actively managed business. In that case, the asset in question was D's minority interest in a closely held bank. Before her death, D's conservator entered into an agreement that fixed the value of D's shares. The court held that the term "bona fide business arrangement" encompassed the value-fixing arrangements made by the conservator, who was seeking to exercise prudent management of his ward's minority stock investment consistent with his fiduciary obligations to the ward and to provide for the expected liquidity needs of her estate.

(1) "Here, however, we do not have a closely held business." The Holman partnership carried on little activity other than holding the shares of stock in Dell, which is not a closely held business. Unlike the situation in *Estate of Amlie*, "[t]here was no closely held business here to protect, nor are the reasons set forth in the Committee on Finance report [on §2703] as justifying buy-sell agreements consistent with petitioners' goals of educating their children as to wealth management and "disincentivizing" them from getting rid of Dell shares, spending the wealth represented by the Dell shares, or feeling entitled to the Dell shares."

b. **The "device" test**. The court determined that paragraph 9.3 of the partnership agreement flunked the test that the restriction not be a device to transfer property to family members for less than full and adequate consideration. If a

partner made an impermissible transfer, the assignee interest would be redeemed at its fair market value, and not for a price equal to his share of the partnership's net asset value. This redemption at a discount would benefit the partners, all of whom were members of the Holman family. "[W]e have no doubt that [H] understood the redistributive nature of paragraph 9.3. and his and [W's] authority as general partners to redistribute wealth from a child pursuing an impermissible transfer to his other children. We assume, and find, that he intended paragraph 9.3 to operate in that manner, and this intention leads us to conclude, and find, that paragraph 9.3 is a device to transfer LP units to the natural objects of petitioners' bounty for less than adequate consideration."

c. **No opinion given on the "comparable terms" test**. The opinion summarizes at some length the parties' experts' conflicting views on the comparability test.

(1) The government's witness, a law professor, summarized his testimony by saying "based on my experience and based on conversations with more than a dozen practitioners who do this stuff, I couldn't find anybody would do this deal, who would let their client into a deal like this as a limited partner without writing a very large CYA memo, saying: 'We advise against this.'"

(2) Petitioner's expert, an attorney who had drafted or reviewed over 300 limited partnership agreements, testified that the restrictions in the Holman FLP "are comparable to provisions one most often finds in limited partnership agreements among unrelated partners," and that paragraph 9.3 "is not out of the mainstream of what one typically finds in arm's length limited partnership agreements."

(3) To all of which the court concluded: "Even were we to find that paragraph 9.3 is comparable to similar arrangements entered into by persons in arm's-length transactions (thus satisfying section 2703(b)(3)), we would still disregard it because it fails to constitute a bona fide business arrangement, as required by section 2703(b)(1), and is a prohibited device within the meaning of section 2703(b)(2). Therefore, we need not (and do not) decide today whether respondent is correct in applying the arm's-length standard found in section 2703(b)(3) to the transaction as a whole."

5. **Control and marketability restrictions applied by the court**. After extended discussion of the valuation reports of two expert witnesses, the court applied combined control and marketability discounts of 22 percent, 25 percent and 16.25 percent in valuing the gifts in 1999, 2000 and 2001. (Interestingly, these were lower discounts than the 28 percent discount contended for by the Service in its deficiency notice.) These are hardly unimpressive discounts, given that the FLP held only one publicly traded stock.

6. **Case has been appealed to Eighth Circuit on §2703 issue**. The taxpayer has filed an appeal has been filed with the Eighth Circuit Court of Appeals on the §2703 issue, but the government did not timely appeal on the issues found in favor of the taxpayer.

C. … and no indirect gift where gift of LP interests made eleven days after FLP was funded. The opinion in *Gross v. Commissioner*, T.C. Memo 2008-221, was written by Judge Halpern, the same judge who crafted the opinion in *Holman v. Commissioner*, 130 T.C. No. 12 (2008), and the court's decision, in a significantly less complicated scenario, was essentially the same. G, widowed and wealthy, established a family limited partnership

which she believed would encourage her two daughters to work in handling the family wealth while preserving control over the partnership's assets as general partner. After discussions with her daughters, the parties agreed to the outlines of a partnership arrangement under which the daughters would not be able to transfer their LP interests without the consent of the general partner, and could not withdraw from or force a dissolution of the partnership. On July 15, 1998, G filed a certificate of limited partnership with the New York Secretary of State. Two weeks later, the daughters each contributed $10 and G contributed $100, as they had agreed. Beginning in October 1998, G proceeded to transfer more than $2 million of stock in publicly traded companies to the partnership, recording her contributions in the partnership books, with the final funding made on December 4, 1998. On December 15, 1998—eleven days later—G and her daughters execute a limited partnership agreement including the agreed-upon restrictions, and on the same day G gifted 22.25 percent LP interests to each of her daughters. G filed a gift tax return on which she took a 35 percent combined discount for lack of marketability, lack of control and minority interest.

1. The government argued that the partnership was not formed until December 15, 1998, when the partnership agreement was signed. The court ruled, however, that under New York law a partnership, albeit a general partnership, was formed when the LP certificate was filed on July 15. The court rejected both the government's "indirect gift" argument based on *Shepherd v. Commissioner*, 115 T.C. 376 (2000), and it's step transaction argument. In *Holman v. Commissioner*, "[w]ithout intending to draw any bright lines, we rejected the Commissioner's argument because of our conclusion that the taxpayers bore a real economic risk of a change in value of the partnership for the 6 days that separated their transfer of the shares to the partnership and the gift. We reach the same result here, where (1) 11 days passed between petitioner's conclusion of her transfer of the Dimar securities to the partnership and her gifts of interests in the partnership to her daughters, and (2) the Dimar securities were mostly, if not all, common shares of well-known companies. The step transaction doctrine does not cause us to change the actual order of the transactions before us and conclude that petitioner made indirect gifts of 22.25 percent of the value of the Dimar securities to each of her daughters. The form of the transactions here in question accords with their substance."

2. In a footnote the court noted, as in *Holman*, that [t]he real economic risk of a change in value arises from the nature of the Dimar securities as heavily traded, relatively volatile common stocks. We might view the impact of a 11-day hiatus differently in the case of another type of investment; *e.g.*, a preferred stock or a long-term Government bond."

D. But indirect gift where gifts of LLC interests made on the same day the LLC was funded. Two cases out of the state of Washington reached the same result on similar facts.

1. In *Linton v. United States*, 2009 WL 1913255 (W.D. Wn. 2009), real property, cash, and municipal bonds were contributed to an LLC on January 21, the same day that gifts of LLC interests were made to trusts for the benefit of L's children. The trust agreement itself stated that the gifts to the trusts were made "[a]t the time of signing of this Agreement." Granting the government's motion for summary judgment, the court cited *Shepherd v. Commissioner*, 283 F.3d 1258 (11th Cir. 2002), and *Senda v. Commissioner*, 433 F.3d 1044 (8th Cir. 2006), in ruling that the transfers involved indirect gifts, and that the 47 percent valuation discounts sought by L should not be recognized.

a. The court noted that "[t]he case before this Court bears little resemblance to" *Holman v. Commissioner, supra*, and *Gross v. Commissioner, supra*, noting not only the 6-day and 11-day delays in funding that were involved in those cases, but also the volatility of the assets involved.

b. The court denied L's request to reform the documents to indicate that the trusts' creation and funding occurred on January 31, and noted that even if the trusts were so reformed, the step transaction doctrine would be applied to the transaction.

2. The same district court (but a different judge) reached the same result in *Heckerman v. United States*, 2009 WL 2240326 (W.D. Wn. 2009), where mutual funds were contributed to an LLC and on the same day gifts of LLC interests were made to trusts for the grantors' children. The court granted the government's summary judgment on the same grounds as in *Linton v. United States*: the transfers were indirect gifts, the step transaction doctrine applied, and the transfers did not involve assets subject to volatility in value.

E. Was it a gift or a loan? Summary judgment not available. In *Barnett v. United States*, 2009-2 U.S.T.C. ¶60,576 (W.D. Pa. 2009), D made a payment of $350,000 to Son two years before his death. The estate characterized the transfer as a partial repayment of a loan that D's business had made to Son, but the government treated the payment as a gift and sought summary judgment. No go, said the court. The estate provided evidence that a loan to Son was shown on the business's books as a note payable, and D's accountant testified that he had created an amortization schedule for repayment of the loan. We have a genuine issue of material fact, said the court, and thus summary judgment was not available.

XV. Section 2518—Qualified Disclaimers

A. Wife's disclaimer of survivorship interest in joint accounts approved despite some activity after husband's death. In Ltr. Rul. 200832018, H and W had two brokerages accounts with Brokerage Firm. H was the sole contributor to Account 1, and H and W contributed equally to Account 2. After H's death, Brokerage Firm transferred the assets to new accounts: Wife Account 1 and Wife Account 2. W received distributions of $$$ from Wife Account 1 and authorized the purchase of securities for Wife Account 2. W proposes to disclaim of assets in Account 1 (including the income thereon since H's death) less the $$$ distributed to her. W also proposes to disclaim H's one-half interest in Account 2 minus H's one-half interest in the new securities purchased after H's death. Finally, as the disclaimed interests will pass into trusts in which W has been given testamentary powers of appointment, W proposes to disclaim those powers. The Service gave its blessing to the proposed disclaimers.

1. The Service noted first that since H had the right to unilaterally withdraw his interest in Account 1 and his one-half interest in Account 2, any gift to W was incomplete until H died. Accordingly, W had nine months from H's death in which to disclaim. Also, merely retitling the accounts did not constitute an acceptance of benefits.

2. As for Account 1, although W had accepted distributions from the account, the $$$ that she received was a severable asset, and W can make a pecuniary disclaimer of the assts originally held in Account 1 minus $$$ and the income earned thereon. Similarly, although W accepted portions of Account 1 by authorizing the reinvestment of assets, since the newly acquired assets were severable, W could make

a qualified pecuniary disclaimer of H's interest in Account 2 less H's interest in the newly acquired assets plus the income earned thereon.

3. Finally, W had to (and did propose to) disclaim her powers of appointment over the trusts to which the assets passed by reason of the disclaimers.

XVI. Section 2519—Disposition of QTIP Life Estates

A. **Effect of settlement that results in partial collapse of QTIP trust**. In Ltr. Rul. 200844010, a trust for which a QTIP election was made provided for income to S for life, remainder in further trust for D's five children and their descendants. A dispute arose as to investment and management of the trust "[d]ue to different investment philosophies and risk tolerances." Child 1 instituted litigation against co-trustees S and Bank and the other four children. As the result of a mediated settlement, the QTIP trust is to be divided into five trusts, and the trusts for Children 2 thru 5 are to be converted into unitrusts pursuant to state law. The trust for Child 1 is to be terminated, and W will receive property equal to the actuarial value of her life interest. The balance is to be distributed to Child 1 subject to any gift tax liability resulting from the termination, with W having exercised her §2207A right to recover any resulting gift taxes.

1. In the ruling, the Service concluded that with respect to the four "Surviving Settlement Trusts, for §2519 purposes there was no transfer and thus no gift tax consequences." As the termination of Child 1's Settlement Trust was a transfer for §2519 purposes, W will have made a gift of the value of that trust less the value of W's income interest, with the gift reduced by the amount of the gift tax attributable to the transfer (*i.e.*, net gift treatment).

XVII. Section 2601—Generation-Skipping Transfer Tax

A. **Formula bequest tied to unused GST exemption was a pecuniary bequest that did not share in appreciation.** In Ltr. Rul. 200848009, T's residuary estate passed to a revocable trust that became irrevocable on T's death. The trust provided that after debts and expenses were paid, there was to be set aside for a GST Trust "an amount equal to [T's] GST exemption not allocated to lifetime direct skips." The balance was to be held in two trusts, one for T's wife and the other for T's descendants. At T's death, the trust consisted primarily of T's business interests that were subject to various claims. Because it was not possible to satisfy the outstanding obligations, the trustee continued to administer the trust for X years. With the obligations having been satisfied and the trust assets having substantially increased in value, the trustee wants to distribute a pro rata portion of the increased value to the GST Trust. The trustee has obtained a local court ruling that the formula clause made a fractional share gift and not a gift of a pecuniary amount.

1. No dice, said the Service. The trust made a gift of a pecuniary amount, and under *Commissioner v. Estate of Bosch*, 387 U.S. 456 (1967), the local court ruling carries no weight. Thus the amount to be distributed to the GST was frozen as of T's death, and did not share in the appreciation. Moreover, because the funding will be in satisfaction of a pecuniary amount, distributions in kind will trigger gain or loss.

B. **Reformation to correct scrivener's error; limited powers of appointment were intended.** Ltr. Rul. 200852014 involved pre-1985 trusts for the benefit of Settlor's three

daughters. Each trust gave a daughter a power of to appoint to "any person or persons except that such power shall on no account be exercised in favor of herself, the Trustees, her creditors or the creditors of her estate." Settlor has been advised that the trusts do not expressly preclude appointment to a beneficiary's "estate," and represents that his intent was to give the daughters non-general powers of appointment. He has obtained a court ruling to correct the mistake by replacing "the Trustees" with "her estate." We'll buy that, said the Service. The trusts' grandfather exemptions are not affected.

1. In Ltr. Rul. 200910003, on G's death her trust was divided into a GST-exempt trust and a non-exempt trust pursuant to a formula tied to G's unused GST exemption. The exempt trust gave G's daughter D a power to appoint among G's descendants—and of course D was G's descendant. The Service ruled that it would recognize a reformation to clarify that D could not appoint to himself. Thus, the trust will remain grandfathered from the GST, with no estate tax exclusion in D's estate.

C. **Allocation of GST exemption disregarded when it wasn't needed**. In Ltr. Rul. 200838022, a trust gave D's daughter a general testamentary power of appointment, causing any undistributed principal to be includible in the daughter's gross estate. Because the allocation was ineffective, D's GST exemption was automatically allocated to two other trusts, a residue trust and an insurance trust, on a pro rata basis.

1. In Ltr. Rul. 200910004, allocation of exemption to an exempt marital trust was void because it exceeded the amount necessary to achieve an inclusion ratio of zero.

D. **Partnership interest acquired to satisfy Comptroller of Currency will not cause loss of GST-exempt status**. In Ltr. Ruls. 200902008, 02009 and 02010, the trustees (Bank and two individuals) of GST-grandfathered trusts placed marketable securities in a custodian account with Financial Services Corporation, with the objective of obtaining integrated reporting, financial consulting, and assistance with asset management. Bank's counsel advised that regulations published by the Office of the Comptroller of the Currency required that trustees maintain custody of all trust assets. Also, Bank's internal policies require that Bank must maintain custody of trust assets. To resolve the problem, the trustees created Partnership and transferred trust assets in exchange for a 99.9 percent Partnership interest. At the end of the day, the trustees have custody of the partnership interest, and Partnership has transferred assets to the FSC custodial account. No problem, said the Service. The transactions did not result in a shift in beneficial interest to a lower generation beneficiary.

E. **Late allocation means that Family Trust was not tainted**. Under the facts of Rev. Rul. 200901013, when H died a QTIP election but no reverse QTIP election was made for a Marital Trust—but that oversight was not at issue in the ruling. On W's subsequent death, the Marital Trust was of course includible in her gross estate, and was so reported on the estate tax return. The trust provided that on W's death the trust estate was to be distributed as W should appoint among issue. If W did not exercise the power of appointment (she didn't) and any of W's GST exemption was allocated to the trust, the assets would (to that extent) be added to the Family Trust created by H (which was exempt from the GST). Despite that red-flag reference to the GST and allocation of exemption, no allocation was made on W's estate tax return. The oversight came to light when the trustees of Family Trust and Marital Trust were preparing to consolidate the trusts' assets. The Service affirmed the late allocation of GST exemption.

F. **Modification to included adopted issue will result in taxable gifts, but will not cause loss of GST-exempt status**. The trust in Ltr. Rul. 200917004 provides for income to Child

for life, remainder to "living lawful issue." The trust specifies that adopted issue are barred from receiving distributions. Child A has two natural children (Grandchild A and Grandchild B) and an adopted child (Grandchild C). Grandchild A has two legally adopted children. The ruling sought the Service's blessing on a modification that will eliminate the exclusion of adopted descendants. You can do it without affecting the trust's GST-exempt status, said the Service, but the modification will result in taxable gifts.

G. **Division of GST-exempt trust was needed to preserve ESBT status because nonresident alien was potential beneficiary.** In Ltr. Rul. 200913002, the grandfathered trust, which qualified as an electing small business trust, had a potential current beneficiary who married a resident alien. Because spouses were included as beneficiaries, the resident alien also became a potential beneficiary. There would be no problem if the story stopped here. If, however, the resident alien were to become a nonresident alien, the trust would lose its ESBT status. The trustees want to divide the trust into two trusts.

1. Trust A will hold stock in a company for which ESBT status is to be maintained, and Trust B will hold other assets. Trust A will then be judicially modified to prohibit distributions to a nonresident alien for as long as the trust hold S corporation stock. The Service ruled that these actions will not cause either trust to lose its GST-exempt status.

2. The same trust was the subject of two earlier letter rulings, discussed but not cited in the ruling. In one ruling, the Service had approved merger of two trusts in another trust. In another ruling, the Service approved disclaimer of a power of appointment to enable qualification as an ESBT.

H. **Modification of post-1985 GST-exempt trust**. In Ltr. Rul. 200841027, the trust was modified to increase discretionary distributions, change the situs of the trust, and increase the number of trustees. The trust was exempt from the GST because of the allocation of sufficient GST exemption. Noting that no guidance has been issued concerning modifications that may affect the status of such trusts, the Service determined that, at a minimum, a change that would not affect the GST status of a pre-1985 trust should similarly not affect the exempt status of a post-1985 exempt trust. As is illustrated by Reg. § 26.2601-1(b)(4)(i)(E), Example 7, a modification increasing discretionary distributions does not shift a beneficial interest to lower generation beneficiaries or extend the time for vesting of beneficial interests. Change of the trust's situs, where both the original state and the new state do not have a rule against perpetuities, would not change the trust's inclusion ratio from zero. Finally, a change in the number of trustees is an administrative change that does not affect the trust's inclusion ratio.

XVIII. Section 2702—Special Valuation Rules: Trust Transfers

A. **Transfer to QPRT followed by sale of remainder not a taxable gift.** In Ltr. Rul. 200840038, a revocable trust established by H and W (who reside in a community property state) purchased a vacation home. H and W had a preexisting irrevocable trust (called in the ruling the "Purchasing Trust") for the benefit of their descendants. H and W propose to establish a trust that meets the requirements of a QPRT for their joint lives, with the remainder on the death of the survivor to pass to the Purchasing Trust. After the trust is established, H and W will transfer the vacation home to the QPRT, and the Purchasing Trust will transfer to H and W cash and marketable securities an amount equal to the value of the remainder interest as determined under the §7520 term interest tables. The Service ruled the transaction will not constitute a taxable gift because the consideration received by

H and W will be equal to the value of the remainder interest transferred. Accord on similar facts, see Ltr. Rul. 200919002.

1. **Will this transfer avoid a gross estate inclusion?** The ruling ends by stating that "[w]e express no opinion on whether the corpus of Trust will be includible in the gross estate of either Husband or Wife under § 2036 or any other provision of the Code."

2. **This plan is aggressive and should work—but is it economically viable?** The ruling request and the plan are inspired by the "sale of remainder" transaction that was used in the early 1980s, when the interest factor used to value term interests and remainder was 10 percent. (Congress hadn't invented §7520 yet.) Example: In 1985, 59-year-old Winnie, who owns land worth $500,000, sells a remainder interest in the land to her daughter Donna. Under the 10% term interest tables, the value of a remainder following a life estate in a 59-year-old person was .25 times the principal amount. So, Donna purchases a remainder interest in the land from Winnie for the full $125,000 value of the remainder interest. The transfer will have been for a full and adequate consideration, with no gift component. On Winnie's death, Donna will acquire the land worth $500,000 (plus any appreciation from the date of the transaction—the transaction had a "freeze" component) for a purchase price of only $125,000. Moreover, only the sale proceeds of $125,000 (and not the value of the property) will be includible in Winnie's gross estate since (after the sale) she had only a life estate.

   a. **The Service didn't like sale-of-remainder transactions, but the courts upheld them**. *Estate of D'Ambrosio v. Commissioner*, 101 F.3d 309 (3rd Cir. 1996); *Wheeler v. United States*, 116 F.3d 749 (5th Cir. 1997); *Estate of Magnin v. Commissioner*, 99-2 U.S.T.C. ¶60,347 (9th Cir. 1999).

   b. **Section 2702 shot down sale-of-remainder arrangements—but only when the remainderman is a "member of the family."** If the remainderman is "a member of the family," the grantor-seller ends up with a retained interest—a life estate. As the life estate is not in the form of an annuity or unitrust interest, §2702 applies. In my 59-year-old Winnie example, under today's law Winnie would be deemed to have made a transfer of $500,000 minus the $125,000 consideration received, for a taxable gift of $375,000.

   c. If, however, the client does not have descendants ("members of the family" within the meaning of §2702), and the object of the client's bounty is a nephew or niece, or the child of a friend, or a companion, the sale of remainder transaction is alive and well, according to the decisions cited above. The central problem with the transaction is that the current §7520 interest rate environment (with interest rates in the 2.4 to 4 percent range), tends to make the remainder interest costly. The (substantial) consideration received from the sale will be in the grantor's gross estate, and the real benefit will come from post-transfer appreciation (if any).

   d. The taxpayers in Ltr. Rul. 200840038 are using the QPRT exception to execute a sale of remainder that benefits members of the family. As it did in similar rulings on this issue (Ltr. Ruls. 9841017 and 200112023), the Service expressly declined to rule on the applicability of §2036 to the transaction. If on either spouse's death the Service takes the position that there is a §2036 gross estate inclusion, the estate should lick its chops. With Courts of Appeal in the Third, Fifth and Ninth Circuits having rejected the government's contention, the Service would be taking a position

that is not substantially justified, and court costs and attorney's fees under §7430 should be awarded.

B. **Grantor can retain a substitution power in a GRAT**. In Ltr. Rul. 200846001, G created a GRAT, retaining the right to acquire any property in the GRAT by a substitution of other property of equivalent value. The power is exercisable in only a fiduciary capacity, defined as an action taken in good faith and in the best interest of the trust and its beneficiaries, and subject to fiduciary standards imposed under state law. The Service ruled that neither the existence of the substitution power nor its exercise would disqualify G's annuity interest from being a qualified interest.

1. A substitution power exercisable in a nonfiduciary capacity is often used to give a trust grantor trust status. In its ruling, the Service noted that the substitution power was exercisable only in a fiduciary capacity—but all the Service did was to note this. It is not clear whether this distinction impacted the Service's ruling.

C. **Reverse QPRT approved—but they should have picked a longer QPRT term in the first place**. In Ltr. Ruls. 200904022 and 200904023, Father and Mother transferred their interests in a residence to a qualified personal residence trust for a term of years. On expiration of the term, the trusts continued for the benefit of Son and Daughter, with the trusts to terminate in favor of Son and Daughter on the later to occur of the death of Father or Mother. With the term of years having expired, Son and Daughter propose to create a new trust to which they will transfer their interests in a residence to QPRT trusts for the benefit of Father and Mother. No problem, said the Service. In measuring the value of their gifts, the special valuation rules of §§ 2702(a)(1) and (2) will not apply.

1. A similar situation was encountered in Ltr. Ruls. 200848003 and 200848007. Parent transferred his residence to a QPRT. Upon the expiration of the term, the trust was liquidated and distributed to Children. Children now propose to create a trust under which Parent will have the right to possession of the residence for a term of years, with Children retaining the reversion. The Service gave its blessing, noting that although a QPRT is typically used to gift the remainder interest while retaining use of the residence for a term of years, a trust can qualify as a QPRT when the grantor gifts the use of the property for a term of years and retains the reversion.

2. Accord on similar facts, see Ltr. Ruls. 200920033 and 200919002.

D. **Estate tax treatment of GRATs clarified**. Regulations amending Reg. §20.2036-1, published on July 14, 2008, provide that if the grantor dies during the GRAT term, the gross estate inclusion will be the amount of trust corpus necessary to yield the annuity or untrust payment, utilizing the §7520 interest rate in the month of the decedent's death. That gives a clear result if the annuity payout is constant, but the regulations did not address a gdraduated GRAT, under which the annuity increases (up to 20 percent per year) during the trust term. The issue has been clarified under proposed regulations published on April 30, 2009. Under the proposed regulations, the amount included in the grantor's gross estate is equal to the sum of:

1. The amount necessary to generate income equal to the grantor's retained annuity or unitrust payment, using the § 7520 rate in effect on the grantor's date of death as the rate of income generated, for the trust year in which the decedent died; and

2. For each succeeding year of the trust, the amount necessary to generate income equal to the increase in the annuity or unitrust payment, using the § 7520 rate in effect as of

the grantor's date of death as the rate of income generated, deferred until the beginning date of that increase.

XIX. Section 6161—Extension of Time for Payment of Tax

A. **You should have been more specific in asking for an extension to pay the tax**. In *Baccei v. United States*, 2008-2 U.S.T.C. ¶60,562 (N.D. Cal. 2008), the court ruled that late payment penalties and interest totaling $128,755 were properly assessed against an estate because the executor did not request an extension of time to pay the estate tax. The statement attached to the estate's request for an extension to file the return referred only to the estate's inability to pay the tax, and did not specifically ask for an extension or identify the amount of extension requested.

B. **No deduction for interest accrued on estate tax during period of extension**. So ruled in CCA 200836027, concluding that interest on the deferred payment of estate tax was nondeductible personal interest under §163(h)(2). The Chief Counsel's office noted that some interest accrued on estate tax during a period of extension is deductible under §163(h)(2)(E). However, that provision applies only when an extension is granted under §6163. Because the estate's extension was granted under §6161 and not §6163, it could not deduct the interest.

XX. Section 6166—Extension to Pay Estate Tax, Closely Held Business

A. **Don't ask for an extension to make a §6166 election, because you're not going to get it.** In C.C.A. 200848004, the CPA retained to prepare the Form 706 requested an extension of time to file the return, and attached a statement that it was anticipated that the estate would be eligible for a §6166 election. The National Office concluded that the statement attached to the request for an extension was not itself a §6166 election, particularly when it merely stated that it was anticipated that an election would be made.

1. Of greater import, the National Office concluded that a §6166 election is a "statutory election" and not a "regulatory election." As a consequence, while Reg. §301.9100-3 authorizes the granting of extensions, "these extensions are only available for regulatory elections" and not statutory elections.

B. **Qualifying for a §6166 election.**

1. **This real property enterprise qualified**. In Ltr. Rul. 200842012, D's Company owned, developed, managed and leased property, and Company employees were involved in all aspects of the business, including locating tenants and maintaining and recording business transactions. A separate group of employees was responsible for day-to-day repairs, maintenance and other tasks, and an office with regular business hours was maintained for a secretarial, accounting and clerical staff. That satisfies Rev. Rul. 2006-34, I.R.B. 2006-26, 1171, said the Service. Company was actively involved in a trade or business within the meaning of § 6166(b)(1)(C).

2. **But this one only partially qualified** In Ltr. Rul. 200845023, the value of Properties A and B, held by a D's wholly-owned LLC, qualified under §6166. As a full time employee of the LLC, D handled all aspects of the day-to-day management of the properties. D and other employees and agents set rental rates and lease terms,

reviewed rental applications, executed leases, collected rents, terminated leases, authorized repairs, maintained the buildings and grounds, hired contractors, and oversaw their work.

a. However, the value of Property C did not qualify. Property C was considered a passive asset of the LLC, because neither D nor her LLC provided any management services with respect to the property.

XXI. Section 6324—Special Liens for Estate and Gift Taxes

A. **Transferee liability imposed**. In *United States v. Bevan*, 2009-1 U.S.T.C. ¶60,570 (E.D. Cal. 2008), D's children were liable for unpaid estate tax liability as transferees of D's nonprobate assets and as trustee of D's trust. The estate's outstanding debt to the IRS was $3.33 million, plus statutory interest and other additions that continued to accrue until the debt was paid. Daughter as trustee transferred trust property to herself and to Son. Daughter's personal liability as trustee was $3.126 million, the value of assets held by the trust on D's date of death. In addition, Daughter's liability as a transferee of the estate was $978,000, the date of death value of nonprobate assets she received from the trust. Son's liability as a beneficial transferee of the estate was $1.585 million, the date of death value of nonprobate assets that he received from the trust.

XXII. Section 6324A—Special Lien for Estate Tax

Deferred Under Section 6166

A. **Collateral required to secure §6324A lien**. In CCA 200909044, the Office of Chief Counsel advised that the maximum value of collateral that the Service may require to secure a special estate tax lien under §6324A shall not exceed the sum of the "deferred amount" (the aggregate amount deferred under §6166) plus the "required interest amount" (the aggregate amount of interest that will be payable over the first four years of the deferral period with respect to the deferred amount).

XXIII. Section 6511—Limitations on Credits or Refunds

A. **Informal claim doctrine satisfied.** So held in *Estate of Wilshire v. United States*, 2008-2 U.S.T.C. ¶60,569 (S.D. Ohio 2008). S's will provided that charitable bequests therein should not be charged with the payment of estate tax. The executor filed the estate tax return with a note explaining that the charitable calculation was interrelated with the estate taxes due, and that an amended return would be submitted upon completion of the calculations. An amended return was filed in November 2001, but the accountant had charged the charitable bequest with estate tax. Over the next two years, the executor made written and oral requests for a refund. In 2004, the executor discovered that the tax returns had improperly burdened the charitable bequests with tax, and filed a formal refund claim after the §6511 period had expired.

1. The court concluded that the will, the executor's note explaining the proper calculations of the tax, and the executor's written and oral requests for a refund put the Service on notice of the estate's assertion of a refund claim. This constituted an informal claim for refund that was perfected by the formal refund claim. An

additional factor was that the Service had purged its file on the estate after it was given notice of the refund claim, and this (said the court) warranted a negative inference against the Service. The court ordered a refund of an estate tax overpayment of $429,542 plus interest.

B. **If the statute of limitations has run, you lose.** So held in *Simmons v. United States*, 2008-2 U.S.T.C. ¶60,564 (S.D. Ill. 2008), where, because of ongoing litigation after S's death, the estate requested an extension to file and paid the maximum amount of estimated estate tax. The Service granted a six-month extension. The estate filed the Form 706 more than four years later and claimed a refund. You're too late, said the Service, and the court agreed. The refund claim was made outside the 3½ year look-back period permitted under §6511. Therefore, the district court lacked jurisdiction over the refund claim.

XXIV. Section 6651—Failure to File Return or Pay Tax

A. **No penalty even though estate claimed marital deduction for interest "passing" to deceased spouse**. In *Estate of Lee v. Commissioner*, T.C. Memo 2007-371, although W died 46 days before D died, "[t]he estates of decedent and Ms. Lee were administered as though decedent had predeceased Ms. Lee. The estate tax returns were filed as if decedent died first, and [d]ecedent's estate's tax return claimed the marital deduction as to the residuary purportedly transferred to Ms. Lee." Not surprisingly, the Tax Court, noting that "the term 'surviving spouse' requires that a spouse actually survive his or her spouse," denied the deduction.

1. In *Estate of Lee v. Commissioner*, T.C. Memo 2009-84, the Tax Court ruled that the estate was not liable for an addition to tax for failing to timely file or an accuracy-related penalty. The executor reasonably relied on the attorney hired by the estate who was deemed to be a specialist (!) in estate planning, estate administration, and the preparation of estate tax returns.

XXV. Section 7520—Valuation Tables

A. **New valuation tables**. On May 1, 2009, the Service issued regulations that revise the mortality tables based on date compiled from the 2000 census as set forth in Table 2000CM. The prior tables were based on the 1990 census. Because of increased life expectancy data, the tables increase (slightly) the value of life interests and reduce the value of the remainders that follow them.

XXVI. In Conclusion….

A. **Don't draft a will for a divorced client that undercuts the divorce decree!** That's just one of several lessons from *Tensfeldt v. Haberman*, 2009 WL 2016935 (Wis. 2009). When Robert divorced his first wife in Wisconsin in 1974, the parties entered into an agreement (incorporated into the divorce decree) under which Robert agreed to execute a will that bequeathed two-thirds of his estate to the couple's three children. Robert married Constance in 1975. In 1978, Robert executed a will that complied with the divorce decree. In 1980, Robert retained LaBudde to provide estate planning services. Robert showed LaBudde a copy of the divorce decree, to which LaBudde "told Robert that he had three choices: comply with the stipulation; negotiate with the children to alter his obligation; or

ignore the stipulation, knowing that the children might contest Robert's will upon his death." Robert chose the third option, and in 1981 LaBudde prepared an estate plan that did not comply with the divorce decree.

1. Some time later, LaBudde received a letter from Robert's attorney in the divorce proceeding. The letter enclosed a copy of the decree and suggested that "[t]here does not seem to be any sanction against disposition of assets during his lifetime." LaBudde wrote back: "In my opinion, Mr. Tensfeldt's present Will needs some revision in light of the obligations under the divorce decree, *of which I was unaware until receipt of your letter*." [Emphasis added.] Although Robert and Constance moved to Florida in 1985, they retained Wisconsin attorney LaBudde for estate planning services, who prepared several other wills—including the 1992 will in place when Robert died in 2000—that did not comply with the divorce decree. The will, after making bequests of some property to the three children, left the bulk of the estate to a trust giving Constance an income interest for life. On her death, after cash payments to Constance's three children, the balance of the trust passed to the Tensfeldt children.

2. **Why you shouldn't represent a client after he moves to another state**. After LaBudde scaled back his practice, Haberman (an attorney in the same Wisconsin law firm) took over the representation. "When he met with Robert in 1999, Haberman was unaware of a recent Florida case that would have a substantial impact on the distribution of Robert's assets. This decision, *Bravo v. Sauter*, 727 So.2d 1103 (Fla. Ct. App.1999), allowed a surviving spouse to elect against the will (thereby taking 30 percent of the estate off the top) and continue to receive income from the revocable trust for the remainder of her life. Because he was unaware of *Bravo*, Haberman did not inform Robert of the likely impact of this decision—that Constance could elect to receive a larger share of the estate than Robert contemplated and to defer the bulk of the Tensfeldt children's inheritance until after her death. It is undisputed that Haberman was negligent in failing to properly advise his client."

3. The will was probated in Florida, and Constance filed for an elective share. A spate of litigation (surprise!) led to a decision that Constance's election was timely, and that under *Bravo* she could both receive an elective share of the estate and income from the trust. *Tensfeldt v. Tensfeldt*, 839 So.2d 720 (Fla. App. 2003). In addition, Constance was awarded attorney's fees of $444,000, to be taken from the Tensfeldt children's portion of the estate. Ultimately, the parties settled the dispute. After settling, the children filed suit in Wisconsin against attorneys LaBudde and Haberman on various theories, as to which all parties moved for summary judgment.

4. **LaBudde's liability for intentional tort affirmed**. The Wisconsin Supreme Court affirmed the trial court's ruling "that LaBudde is liable as a matter of law for aiding and abetting his client's unlawful act. The divorce judgment was enforceable at the time it was entered and at the time Robert asked LaBudde to draft an estate plan that violated the judgment. Under these facts, LaBudde is not entitled to either qualified immunity or the good faith advice privilege."

4. **But LaBudde could not be held liable for negligence.** An earlier Wisconsin decision had rejected the "privity of contract" defense to a claim of attorney liability for negligence. As the Tensfeldt children were named in the will, they had standing to bring a negligence action. However, "[i]t is undisputed that LaBudde carried out Robert's explicit instructions when he crafted an estate plan that did not leave two-thirds of Robert's net estate outright to his children. To this end, we determine that the children's third party negligence claim cannot be maintained because they cannot

establish that LaBudde's negligence thwarted Robert's clear intent. We conclude that the circuit court erred in denying LaBudde's motion for summary judgment on the negligence claim."

5. **Haberman could not be held liable although negligent because it could not be shown what Robert had done if correctly informed.** "The circuit court correctly determined that the children's evidence of injury was speculative, and was therefore insufficient to raise a genuine issue of material fact…. [T]here is simply no way to make even an educated guess about what Robert would have done had he understood that this distribution plan would not be carried out due to *Bravo*…. Under these circumstances, we conclude that the circuit court did not err in granting summary judgment."

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