Scouting Report: Recent Developments in Federal Wealth Transfer Taxation

Hampton Roads Estate Planning Council

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**LEGISLATIVE AND REGULATORY DEVELOPMENTS**

* 1. **President Biden’s Tax Proposals (As of May 5, 2021)**

**President Biden has made various tax proposals before taking office and since taking office**

**Biden Policy Proposals During the 2020 Presidential Campaign**

The following is a list of some of the significant changes President Biden highlighted in his campaign:

* Increasing the top income tax rate for taxable incomes above $400,000 from 37 percent to 39.6 percent (pre-2017 Tax Act highest rate).
* 12.4 percent Social Security tax on earned income above $400,000 to be split evenly between employers and employees.
* Taxing long-term capital gains and qualified dividends at the ordinary income tax rate of 39.6 percent on incomes above $1,000,000.
* Eliminating the step-up in basis at death for capital gains taxation and taxes the appreciation at transfers. This proposal appears to create a capital gains tax at death and possibly when appreciated assets are gifted during life.
* Capping the benefit of itemized deductions to 28 percent of value for those earning more than $400,000.
* Restoring the Pease limitation on itemized deductions for taxable incomes above $400,000.
* Phasing out the Section 199A qualified income business deduction for taxpayers with income over $400,000.
* Expanding the Earned Income Tax Credit for childless workers age 65+.
* Restoring the estate and gift tax rates and exemptions to 2009 levels. This would mean a fixed $3,500,000 estate and generation-skipping tax exemption and a fixed $1,000,000 gift tax exemption with a top rate of 45 percent on amounts over $1,500,000.
* Increasing the corporate income tax rate from 21 percent to 28 percent.

**The American Jobs Plan; Made in America Tax Plan (March 31, 2021)**

On March 31, 2021, President Biden introduced The American Jobs Plan, a wide-ranging and comprehensive plan to:

* Build world-class transportation infrastructure;
* Rebuild clean drinking water infrastructure, a renewed electric grid, and high-speed broadband to all Americans;
* Build, preserve, and retrofit more than two million homes and commercial buildings; modernize America’s schools, community colleges, and early learning facilities, and upgrade Veterans’ hospitals and Federal buildings;
* Solidify the infrastructure of the care economy by creating jobs and raising wages and benefits for essential home care workers;
* Invest in R&D, revitalize manufacturing and small businesses, and train Americans for the jobs of the future; and
* Create good-quality jobs that pay prevailing wages in safe and healthy workplaces.

This plan addresses spending priorities in detail aimed at driving the policy outcomes in the pending legislation.

President Biden included provisions to pay for the ambitious agenda through the Made In America Tax Plan. The administration framed the tax provisions as a response to the 2017 Tax Cuts and Jobs Act and estimate that the provisions would raise as much as $2.5 trillion over 15 years. Independent estimations put the revenue targets at raising $2.1 trillion over 10 years.

The Made in America Tax Plan would:

* Raise the corporate tax rate to 28 percent;
* Enact a minimum 15 percent corporate tax on book income of corporations with revenue more than $100 million;
* Provide a credit for onshoring expenses and deny corporate expense deductions for offshoring expenses;
* Eliminate certain tax preferences for fossil fuels;
* Raise the tax on Global Intangible Low Tax Income (GILTI) to 21 percent, Repeal the Foreign-Derived Intangible Income (FDII) deduction, and take other steps to encourage fair tax treatment of U.S. corporations that operate internationally; and
* Invest in enforcement by providing resources to the Internal Revenue Service.

More information and analysis on The American Jobs Plan and the Made in America Tax Plan can be found at: (i) Fact Sheet: The American Jobs Plan (March 31, 2021) (<https://www.whitehouse.gov/briefing-room/statements-releases/2021/03/31/fact-sheet-the-american-jobs-plan/>) and (ii) President Biden’s Infrastructure Plan Raises Taxes on U.S. Production (March 31, 2021)(<https://taxfoundation.org/biden-infrastructure-american-jobs-plan/>).

**The American Families Plan (April 28, 2021)**

On April 28, 2021, President Biden introduced The American Families plan, a spending package addressing “our kids, our families, and our economic future.” The spending priorities include items such as education, direct support for families, paid leave for family purposes, unemployment insurance reform, extension and expansion of the Child Tax Credit and Child and Dependent Care Tax Credit.

President Biden proposes offsetting the cost of the spending priorities by raising revenue from the following provisions:

* Increase resources and funding available to the IRS to increase enforcement of current tax laws;
* Increase the top marginal tax rate to 39.6 percent on incomes over $400,000, restoring the rate to the pre-2017 Tax Act rate;
* Increase the tax rate on long term capital gains and dividends from 20 percent to 39.6 percent for taxpayers with over $1 million of income;
* Eliminate the “step-up” in basis (under I.R.C. section 1014) for inherited property (for capital gains over $1 million for single individuals and $2.5 million for couples after considering certain existing exemptions);
* Close the “carried interest loophole” by taxing income of hedge fund partners as ordinary income rather than as capital gain;
* Limit the deferral of capital gain through like-kind exchanges for gain exceeding $500,000; and
* Permanently extend the limitation in place that restricts excess business losses.

As of April 29, 2021, the plan did not include proposed legislation. The language in the proposal related to the step-up in basis suggests that the Biden plan will ultimately result in a new realization-on-death system, that would mean that at the death of a taxpayer, the appreciation in assets would be taxed as capital gain, and the beneficiary’s basis would be equal to the fair market value at the time of recognition. There are significant question about the implementation of such a system that will be evident in eventual legislation.

The proposal does not include any reductions in the current $10,000,000 (adjusted for inflation) estate tax, gift tax, and GST exemptions which are scheduled to be reduced to $5,000,000 (adjusted for inflation on January 1, 2026.

**President Biden’s Proposed Budget for Fiscal Year 2022 and Treasury Green Book (May 28, 2021)**

On May 28, 2021, the Biden Administration released its proposed fiscal year 2022 budget and the Treasury Department issued its “Green Book” which provides additional information about the tax proposals included in President Biden’s proposed fiscal year 2022 budget. The proposed budget includes the three major tax changes that are part of the President’s previous proposals:

* + Increasing the top individual tax rate to 39.6 percent on incomes over $400,000;
  + Increasing the corporate tax rate to 28 percent; and
  + Increasing the funding for the Internal Revenue Service to improve tax compliance by individuals and corporations.

The proposed fiscal year 2022 budget also includes the following items of interest with respect to the taxation of trusts and estates:

Elimination of step-up in basis and treating transfers of appreciated property by gift or on death as realization events.

The donor or deceased owner of an appreciated asset will realize a capital gain at the time of the transfer. For a donor, the amount of the gain realized will be the excess of the asset’s fair market value on the date of the gift over the donor’s basis in that asset

For a decedent, the amount of gain will be the excess of the asset’s fair market value on the decedent’s date of death over the decedent’s basis in that asset.

Gain on unrealized appreciation also will be recognized by a trust, partnership, or other non-corporate entity that is the owner of property if that property has not been the subject of a recognition event within the prior ninety years.

The proposal contains the following rules for valuing and taxing the transfer of appreciated assets:

* The value of a transferred partial interest will be its proportional share of the fair market value of the entire property.
* Transfers of property into, and distributions in kind from, a trust, partnership, or other non-corporate entity, other than a grantor trust that is deemed to be wholly owned and revocable by the donor, will be recognition events.
* The deemed owner of a revocable grantor trust will recognize gain on the unrealized appreciation in any asset distributed from the trust to any person other than the deemed owner or the U.S. spouse of the deemed owner, other than a distribution made in discharge of an obligation of the deemed owner.
* All of the unrealized appreciation on assets of a revocable grantor trust will be realized at the deemed owner’s death or at any other time when the trust becomes irrevocable.
* Capital losses and carry-forwards from transfers at death be allowed against capital gains income and up to $3,000 of ordinary income on the decedent’s final income tax return, and the tax imposed on gains deemed realized at death will be deductible on the estate tax return of the decedent’s estate.

The following exclusions are included:

* $1 million per-person exclusion (or $2 million per couple), indexed for inflation after 2022 and portable to the decedent’s surviving spouse, from the recognition of other unrealized capital gains on property transferred by gift or held at death.
* The recipient’s basis in property received by reason of the decedent’s death will be the property’s fair market value at the decedent’s death.
* The same basis rule will apply to the donor of gifted property to the extent that the unrealized gain on that property at the time of the gift was not shielded from being a recognition event by the donor’s $1 million exclusion. However, the donor’s basis in property received by gift during the donor’s life will be the donor’s basis in that property at the time of the gift to the extent that the unrealized gain on that property counted against the donor’s $1 million exclusion from recognition.
* Transfers by a decedent to a U.S. spouse or to charity will carry over the basis of the decedent. Capital gain will not be recognized until the surviving spouse disposes of the asset or dies, and appreciated property transferred to charity will not generate a taxable capital gain.
* The proposal will not recognize any gain on tangible personal property such as household furnishings and personal effects (excluding collectibles).
* The $250,000 per-person ($500,000 per couple) exclusion under current law for capital gain on a principal residence will apply to all residences and will be portable to the decedent’s surviving spouse.
* The exclusion under current law for capital gain on certain small business stock will also apply.

The proposal provides favorable provisions for the deferral and payment of the new capital gains tax at death on the appreciation by family-owned and operated businesses which are akin to the provisions found in Section 6166 for the deferral and payment in installments of estate tax due on a family-owned and operated business. The payment of tax on the appreciation of the business will not be due until the interest in the business is sold or the business ceases to be family-owned and operated. These businesses will also have a 15-year fixed-rate payment plan for the tax on appreciated assets transferred at death, other than liquid assets such as publicly traded financial assets. The IRS is authorized to require security at any time when there is a reasonable need for security to continue the deferral.

The proposal will be effective for gains on property transferred by gift, and on property owned at death by decedents dying, after December 31, 2021, and on certain property owned by trusts, partnerships, and other non-corporate entities on January 1, 2022.

Taxation of capital gains for high-income earners at ordinary rates

Long-term capital gains and qualified dividends of taxpayers with adjusted gross income of more than $1 million will be taxed at ordinary income tax rates, with 37 percent generally being the highest rate (40.8 percent including the net investment income tax), but only to the extent that the taxpayer’s income exceeds $1 million ($500,000 for married filing separately), indexed for inflation after 2022. This proposal will be effective for gains required to be recognized after the date of announcement.

**Budget Reconciliation**

In the special elections held in Georgia in January 2021, Democrats were able to gain both seats, bringing a tie to the Senate. Democrats hold 48 seats, with two Independents (King – ME; Sanders – VT) who reliably caucus with the Democrats. Republicans hold 50 seats. Vice-President Kamala Harris, as President of the Senate, can cast the deciding 51st vote for Democrats on any matters requiring only a majority in the Senate.

This slimmest of majorities has renewed interest in the “budget reconciliation” process. The Senate rules generally require a 60-vote majority to carry revenue raising or revenue spending legislation. However, the Congressional Budget Act of 1974 created the reconciliation process to fast-track certain legislation, so that any legislation enacted through this process requires only 51 votes.

* For each budget year, the House and Senate can initiate this process by enacting a budget resolution for that year with certain “reconciliation directives.”
* The reconciliation process is only effective for legislation that addresses revenue, expenditures, or the debt-limit, and the reconciliation directives can only result in one bill per budget year on each topic. Because revenues and expenditures are so closely linked in federal legislation, the process generally allows only one set of reconciliation directives – or rules for the substantive legislative committees – per budget year on taxing and spending and separately one bill on the debt limit.
* Because no budget resolution was enacted for budget year 2021 (ending on September 30, 2021), the 117th Congress had the opportunity to adopt the 2021 budget resolution with reconciliation directives early in January 2021. With that reconciliation process, the Congress passed the American Rescue Plan on March 6, 2021, which included $1.9 trillion in spending, including direct stimulus payments to Americans.
* The enactment of the American Rescue Plan exhausted the 2021 budget year reconciliation directives. That would have left the 117th Congress with two additional reconciliation procedures, for budget year 2022, beginning October 1, 2021, and for budget year 2023, beginning October 1, 2022. A recent ruling from the Senate parliamentarian, a non-partisan, career staff member, suggest that the 2021 budget reconciliation directives may be amended to allow the Democrats to pursue infrastructure spending paid for by tax increases before September 30, 2021, using amended 2021 reconciliation directives. And then the Senate may take up another revenue/spending bill through reconciliation for budget year 2022, beginning October 1, 2021.

This suggests that the Democrats may have two chances to pass significant legislation, including tax legislation, with 51 votes in this calendar year.

It should be noted that under “regular order” in the Senate, this legislation could be taken up any time if the legislation can carry at least 60 votes.

Any legislation that passes the Senate must also pass the House of Representatives, where Democrats still have a sufficient majority to enact legislation.

* 1. **Legislation Affecting the Transfer of Assets During Life and At Death Introduced in Congress in 2021**

**Legislation to modify or repeal the estate, gift, and generation skipping tax and to introduce a capital gains tax on the transfer of assets during life or at death and forms of wealth tax introduced or discussed in Congress**

Since the start of the 117th Congress in January 2021, numerous changes have been proposed or raised for discussion in either of both the United States House of Representatives and Senate. These proposals generally fall into four categories:

1. Reductions in the exemption and increases in the rates.

2. Imposing a capital gains tax on the transfer of assets at death or during life.

3. Some form of annual tax on the wealth of high net worth taxpayers.

4. Repeal of one of more of the estate tax, gift tax, and generation skipping tax or a reduction in the top rate.

**Senator Sanders introduces bill to make fundamental changes to the estate, gift, and generation-skipping taxes.**

On March 25, 2021, Senator Bernie Sanders (I. Vt.) introduced S 994, “For the 99.5 Percent” Act which would greatly affect the estate, gift, and generation-skipping taxes if ever enacted. This bill is quite similar to the “For the 99.8 Percent Act” which Senator Sanders introduced in the Senate on January 31, 2019 and which Representative Jimmy Gomez (D. Cal.) introduced in the United States House of Representatives in October 2019.

The Act would have a non-indexed $3.5 million exemption for estate tax (and presumably generation-skipping) tax purposes. The non-indexed gift tax exemption would be $1 million. The Act includes anti-clawback rules. The proposed marginal rates are:

$3.5 million to $10 million 45%

$10 million to $50 million 50%

$50 million to $1 billion 55%

Over $1 billion 65%

The Section 2032A special valuation rule cap would be increased from $750,000 indexed for inflation since 1997 to $3 million indexed for inflation since 1997 or about $4.6 million in 2020. The Section 2031(c)(1) maximum exclusion for land subject to a conservation easement would be increased from the lesser of $500,000 or forty percent of the net value to the lesser of $2 million or sixty percent of the net value. The consistent basis reporting rules of Section 1014(f) for estates would be extended to gifts.

The Act restricts the availability of discounts for entities such as limited partnerships and limited liability companies. If an interest in an entity that is not actively traded is transferred for estate and gift tax purposes, the nonbusiness assets held by the entity would be valued as transferred directly from the transferor to the transferee. Also, no lack of control discount would be allowed if the transferor, the transferee, and members of their family or families control the entity or own a majority of the entity’s ownership interests by value.

A new Chapter 16 and a new Section 2901 would eliminate many of the benefits of planning with grantor trusts for third party beneficiaries by treating any distribution during the deemed grantor’s live as a gift, treating the cessation of grantor trust status as a gift, and including the value of the assets at the deemed grantor’s death in the deemed grantor’s estate.

The Act eliminates zero-out GRATs. GRATs would be subject to a ten year minimum term with no decrease permitted in the annual payment. The maximum term would be the grantor’s life expectancy plus ten years. The minimum value of the remainder interest in the GRAT would be the greater of twenty-five percent of the value transferred or $500,000 but not greater than one hundred percent of the value transferred.

The Act would impose an inclusion ratio of one for generations-skipping tax purposes for any trust that is not a “qualifying trust.” A qualifying trust is one that must terminated within fifty years after creation. A trust created before the date of enactment would receive an inclusion ratio of one for fifty years after the date of enactment and would be thereafter subject to generation-skipping tax.

The gift tax annual exclusion would be reduced to $10,000 per donee with a $20,000 annual cap on transfers of assets such as transfers in trust that cannot be immediately liquidated by the recipients.

**Bills to impose a capital gains tax on lifetime and testamentary transfers.**

Two bills have been introduced in Congress to impose a capital gains tax on lifetime and testamentary transfers. On March 30, 2021, Senator Chris Van Hollen (D. Md) introduced the Sensible Taxation and Equity Protection of 2021 (“STEP”) Act. Four Democratic Senators cosponsored the STEP Act. These were Cory Booker (D. NJ), Bernie Sanders (I. Vt), Sheldon Whitehouse (D. RI), and Elizabeth Warren (D. Mass.) The STEP Act work as follows:

1. Tax unrealized capital gains at death (and apparently on lifetime gifts).

2. The income taxes paid would be deductible for estate tax purposes.

3. There would be a $1 million exclusion on unrealized capital gain with a cumulative $100,000 lifetime exclusion.

4. There would be an additional $500,000 exclusion for personal residences.

5. Assets held in retirement accounts would not be subject to the tax.

6. Charitable gifts and bequests would not be subject to the tax.

7. Transfers qualifying for the estate and gift tax marital deductions would not subject to the tax.

8. All non-grantor trusts assets would be subject to the tax every 21 years.

9. Installment payments over a ten-year period would be available for capital gains taxes incurred on the transfer of any illiquid assets at death such as farms and businesses. There would an initial five-year deferral period.

On March 29, 2021, Representative Bill Pascrell (D. NJ) introduced HR 2286, which also would treat property transferred by gift or at death as sold for fair market value.

**Wealth tax proposals**

The Ultra-Millionaire Tax Act of 2021 was introduced as S. 510 in the Senate by Senator Elizabeth Warren (D. Mass) and as HR 1459 in the House of Representatives by Representative Pramila Jayapal (D. WA) on March 1, 2021. It imposes an annual tax on the net assets of an ultra high net worth taxpayer as follows:

1. Two percent tax on the individual net worth of a taxpayer over $50 million.

2. One percent surcharge for the individual net worth over $1 billion.

3. This tax would begin to apply in 2023 based upon the net worth as calculated in 2022.

This tax is estimated to raise approximately $1.4 trillion over a then year period.

Senator Ron Wyden (D. OR), the Chair of the Senate Finance Committee, has issued a report entitled “Treat Wealth Like Wages.” This suggests an annual mark to market tax to fix social security. The proposal eliminates the rate preference for long-term capital gains taxes. It calls for the annual recognition of unrealized capital gains and losses for tradable assets. There is a look-back rule to tax gains from the sale of non-tradable assets upon realization. The proposal has an income threshold of $1 million and an asset threshold of $10 million. Both thresholds must be met for each of the preceding three years.

**Repeal and Rate Reduction Proposals**

Republicans have introduced at least two repeal proposals in Congress in 2021. The first is HR 822, the Permanent Repeal of the Estate Tax Act of 2021, which Representative Robert Latta (R. Ohio) introduced on February 4, 2021. This bill only applies to the estate tax.

The second is the Death Tax Repeal Act of 2021, which was introduced as S 617 in the Senate by Senator John Thune (R. SD) and as HR 1712 in the House of Representatives by Representative Jason Smith (R. MO) on March 9, 2021. It would repeal the estate and generation-skipping taxes completely and have a $10,000,000 inflation-adjusted exemption for the gift tax.

Republicans introduced mirror bills in the House (HR 3178) and the Senate (S 1627) to reduce the top estate tax, gift tax, and GST tax rate from 40 percent to 20 percent on May 13, 2021. S 1627 was introduced by Senator Tom Cotton (R. AR) with two Republican co-sponsors. HR 3178 was introduced by Representative Jodey Arrington (R. TX) with one Republican co-sponsor and one Democrat co-sponsor.

* 1. **IRS Commissioner Rettig Senate Finance Committee Testimony (April 13, 2021)**

**IRS Commissioner testifies on 2021 filing season, COVID, and tax compliance**

On April 13, 2021, Charles P. Rettig, Commissioner of the Internal Revenue Service, appeared before the Senate Finance Committee and provided testimony touching on the IRS handling of the 2021 tax filing season and the operational response to the COVID-19 pandemic.

* In Fiscal Year 2019 (October 1, 2019 – September 30, 2020), the IRS collected $3.56 trillion, which covers 96% of the funding that supports the federal governments operations.
* Through April 2, 2021, the IRS received more than 93.2 million individual federal tax returns and issued more than 62.3 million refunds, totaling more than $180.2 billion.
* IRS attempting to implement automatic correction of certain returns related to the taxability of unemployment insurance, a measure intended to simplify matters for taxpayers. After the 2020 tax filing season open, the rules regarding includability of unemployment benefits changed, and many taxpayers included MORE benefits in income than necessary. The IRS intends to automatically correct the returns and issue refunds or apply overpayments to otherwise due tax.
* The IRS has expanded efforts to curb identity theft.

Tax compliance has become an important discussion as several tax proposals have indicated an intent to increase resources for the IRS to step up enforcement actions. Commissioner Rettig identified the significant changes in the IRS workforce over the last decade.

* IRS funding fell by 20% (adjusted for inflation) since Fiscal Year 2010.
* 70% of the IRS budget goes to the workforce, and this reduction in funding resulted in a 15% decline in full-time employees, including a 31% decline in employees working in enforcement.
* The decline in the workforce had the greatest impact on enforcement for high net worth taxpayers:
  + The number of examining revenue agens (who handle complex enforcement cases) fell by 35%.
  + The number field collection revenue officers (who manage difficult collections cases) fell by 48%.
* The examination rate for individual returns fell by 45% and for businesses with assets equal to or exceeding $10 million by 72%.

Rettig discussed the increased focus on examination of high net worth taxpayers, focusing specifically on taxpayers with incomes above $100,000 who failed to file tax returns in earlier years. Rettig provided the following data on the “exam coverage rate” for certain taxpayers. Exam coverage rate describes closed and in-process examinations, and the most recent tax years with final numbers is tax year 2015. The more recent years have audit windows still open. In tax year 2015:

* The exam coverage rate for taxpayers with income of $10 million or more was approximately 8%, down from 23% in tax year 2010.
* The exam coverage rate for taxpayers between $5-$10 million was 4.39%.
* The exam coverage rate for taxpayers between $1-$5 million was 2.39%.
* The exam coverage rate for taxpayers between $500,000-$1 million was 1.13%.
* The exam coverage rate for taxpayers between $200,000 - $500,000 was 0.55%.

A full transcript of the testimony can be found here: <https://www.finance.senate.gov/imo/media/doc/2021Final%20CPR%20testimony%20SFC%20filing%20season%20041321.pdf>

* 1. **IRS Data Book Statistics for Fiscal Year 2019 (December 2, 2020)**

**IRS issues estate tax filing statistics for fiscal year 2019**

Each year, the Internal Revenue Service – Statistics of Income Division publishes data regarding the number of estate tax returns filed and the assets and deductions claimed on those returns. Generally, an estate files a Federal estate tax return (Form 706) in the year after a decedent's death. So, in 2019, most returns were filed for deaths that occurred in 2018, for which the filing threshold was $11.18 million of gross estate. Because of filing extensions, however, some returns were filed in 2019 for deaths that occurred prior to 2018, for which filing thresholds were lower. There are also a small number of returns filed for deaths that occurred in 2019, for which the filing threshold was $11.40 million.

The following are select statistics pulled from the filing data tables.

|  |  |  |
| --- | --- | --- |
| Taxable Estate Tax Returns | | |
| Estate Tax Returns Filed in 2019 | Number of Returns | Gross Estate ($000s) |
| All Returns | 2,570 | 77,237,685 |
| Under $10 million | 648 | 4,527,552 |
| $10 million < $20 million | 1,020 | 14,854,607 |
| $20 million < $50 million | 636 | 19,170,296 |
| $50 million or more | 265 | 38,685,229 |

|  |  |  |
| --- | --- | --- |
| All Estate Tax Returns | | |
| Estate Tax Returns Filed in 2019 | Number of Returns | Gross Estate ($000s) |
| All Returns | 6,409 | 159,698,178 |
| Under $10 million | 1,975 | 13,790,422 |
| $10 million < $20 million | 2,698 | 38,101,066 |
| $20 million < $50 million | 1,265 | 37,369,180 |
| $50 million or more | 471 | 70,437,509 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| All Estate Tax Returns | | | Returns Reporting: *Personal Residence* | |
| Estate Tax Returns Filed in 2019 | Number of Returns | Gross Estate ($000s) | % of Total Returns | Gross Estate ($000s) |
| All Returns | 6,409 | 159,698,178 | 69% | 6,315,423 |
| Under $10 million | 1,975 | 13,790,422 | 66% | 1,149,935 |
| $10 million < $20 million | 2,698 | 38,101,066 | 71% | 2,337,207 |
| $20 million < $50 million | 1,265 | 37,369,180 | 69% | 1,579,542 |
| $50 million or more | 471 | 70,437,509 | 77% | 1,248,738 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| All Estate Tax Returns | | | Returns Reporting: *Closely Held Stock* | |
| Estate Tax Returns Filed in 2019 | Number of Returns | Gross Estate ($000s) | % of Total Returns | Gross Estate ($000s) |
| All Returns | 6,409 | 159,698,178 | 27% | 12,145,597 |
| Under $10 million | 1,975 | 13,790,422 | 21% | 598,070 |
| $10 million < $20 million | 2,698 | 38,101,066 | 25% | 1,887,396 |
| $20 million < $50 million | 1,265 | 37,369,180 | 31% | 2,330,244 |
| $50 million or more | 471 | 70,437,509 | 53% | 7,329,887 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| All Estate Tax Returns | | | Returns Reporting: *Art* | |
| Estate Tax Returns Filed in 2019 | Number of Returns | Gross Estate ($000s) | % of Total Returns | Gross Estate ($000s) |
| All Returns | 6,409 | 159,698,178 | 19% | 2,447,087 |
| Under $10 million | 1,975 | 13,790,422 | 11% | 42,077 |
| $10 million < $20 million | 2,698 | 38,101,066 | 17% | 206,681 |
| $20 million < $50 million | 1,265 | 37,369,180 | 26% | 324,937 |
| $50 million or more | 471 | 70,437,509 | 43% | 1,873,392 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| All Estate Tax Returns | | | Returns Reporting: *Private Equity and Hedge Funds* | |
| Estate Tax Returns Filed in 2019 | Number of Returns | Gross Estate ($000s) | % of Total Returns | Gross Estate ($000s) |
| All Returns | 6,409 | 159,698,178 | 17% | 4,320,831 |
| Under $10 million | 1,975 | 13,790,422 | 10% | 85,950 |
| $10 million < $20 million | 2,698 | 38,101,066 | 16% | 306,017 |
| $20 million < $50 million | 1,265 | 37,369,180 | 24% | 446,808 |
| $50 million or more | 471 | 70,437,509 | 33% | 3,482,056 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| All Estate Tax Returns | | | Returns Reporting: *Farm Assets* | |
| Estate Tax Returns Filed in 2019 | Number of Returns | Gross Estate ($000s) | % of Total Returns | Gross Estate ($000s) |
| All Returns | 6,409 | 159,698,178 | 12% | 3,368,678 |
| Under $10 million | 1,975 | 13,790,422 | 11% | 432,893 |
| $10 million < $20 million | 2,698 | 38,101,066 | 12% | 1,147,790 |
| $20 million < $50 million | 1,265 | 37,369,180 | 11% | 687,783 |
| $50 million or more | 471 | 70,437,509 | 17% | 1,100,212 |

* 1. **Consolidated Appropriations Act, 2021 (December 27, 2020)**

**Congress extends charitable benefits first provided by CARES Act**

Congress passed the Consolidated Appropriations Act, 2021 on December 21, 2020 by wide bipartisan majorities in both the House of Representatives and the Senate. This Act provided another round of stimulus provisions to address the effects of the COVID-19 Pandemic and funded the operations of the government. President Trump signed the legislation on December 27, 2020.

In the charitable area, the Act extended the $300 charitable deduction for non-itemizers through 2021 and increased the deduction to $600 for joint filers in 2021.

The Act extended the 100 percent of Adjusted Gross Income limitation for gifts of cash to public charities through December 31, 2021.

The Act extended the 25 percent limitation on corporate charitable deductions (increased from 10 percent by the CARES Act) and the 25 percent limitation on contributions of food inventory (increased from 15 percent by the CARES Act) through December 31, 2021.

The Act also (1) reaffirms that the forgiveness of a PPP loan is not included in gross income for US federal income tax purposes and (2) provides that a deduction shall not be denied by reason of that exclusion.

* 1. **Notice 2020-17, 2020-15 IRB 590 (March 18, 2020); Notice 2020-18, 2020-15 IRB 592 (March 23, 2020); Notice 2020-20, 2020-16 IRB (March 27, 2020); Notice 2020-23, 2020-18 IRB 742 (April 9, 2020)**

**Treasury Department extends due dates for the filing of various tax returns and the payment of tax owed**

The series of notices outlines the decisions made by the Treasury Department over a three week period to extend the due dates for the filing of various tax returns and the payment of taxes from April 15, 2020 to July 15, 2020.

Notice 2020-17 was issued by the Treasury Department on March 18, 2020 and postponed the payment of certain income taxes to July 15, 2020, but not the filing of the underlying tax returns.

Notice 2020-18 was issued by the Treasury Department on March 23, 2020 to supersede Notice 2020-17. Notice 2020-18 provides that the due date for filing federal income tax returns and making federal income tax payments due April 15, 2020 was automatically postponed to July 15, 2020. There was no limitation on the amount of the payment that could be postponed. The Notice applied to federal income tax payments and estimated income tax payments. No interest or penalty would be imposed as a result of the postponement. Notice 2020-18 applies to individuals, trusts, estates, partnerships, associations, companies, or corporations.

In Notice 2020-20, the Treasury Department amplified Notice 2020-18 and determined that any gift tax or generation-skipping tax payment due or any gift or generation-skipping tax returns due on April 15, 2020, would be automatically postponed to July 15, 2020. There is no requirement to file a Form 8892 (Application for Automatic Extension of Time) to obtain the benefit of the filing and payment postponement. However, a taxpayer could file a Form 8892 by July 15, 2020, to obtain an extension to file the gift tax return by October 15, 2020 but any gift or generation-skipping tax would still be due on July 15, 2020. No interest or penalty would be imposed with respect to any return or tax now due on July 15, 2020.

The Treasury Department subsequently issued Notice 2020-23 to further expand upon the prior Notices. Notice 2020-23, among other steps, extended the deadline for filing of fiduciary income tax returns and the payment of fiduciary income tax returns for estates and trusts to July 15, 2020. And it extended the due date of estate tax returns to July 15, 2020, but only estate tax returns that otherwise would have been due on or after April 1, 2020, and before July 15, 2020. It may also apply to estate and generation-skipping tax payments owed because of the filing of estate tax return and the payment of any estate and generation-skipping tax otherwise due between April 15, 2020, and July 15, 2020.

Finally, the IRS has posted additional guidance on its website on these issues involving estate and gift tax and fiduciary income tax returns. See <https://www.irs.gov/businesses/small-businesses-self-employed/covid-19-relief-for-estate-and-gift>.

* 1. **H.R. 2954 – Securing a Strong Retirement Act of 2021 (May 4, 2021)**

**Bipartisan bill introduced to expand SECURE Act**

The Chair of the House Ways and Means Committee, Richard Neal (D-MA), with the ranking member of the Ways and Means Committee, Kevin Brady (R-TX) co-sponsoring, introduced the “Securing a Strong Retirement Act of 2021,” which was previously introduce as HR 8696 on October 27, 2020 and is modified here. The bill will expand on the Setting Every Community up for Retirement Enhancement Act (“SECURE Act”) which Congress enacted in December 2019 with broad bipartisan support.

This new act makes the following changes, among many others:

* Increases the age for Required Minimum Distributions (RMDs) from 72 to 73 as of January 1, 2022, 74, as of January 1, 2029, and 75 as of January 1, 2032.
* Allows a one-time $50,000 distribution from and IRA to one of a charitable remainder annuity trust, a charitable remainder unitrust, and charitable gift annuity. The CRAT, CRUT, or charitable gift annuity must be for the sole benefit of the participant and the participant’s spouse and CRAT, CRUT, or charitable gift annuity must be solely funded with qualified charitable contributions.

Given the bipartisan support of the SECURE Act in 2019, it is possible that this bill will pass at some point in 2021.

* 1. **Revenue Procedure 2020-45 (October 26, 2020)**

**IRS announces inflation adjustments for 2021**

The following are some of the inflation adjustments for 2021.

1. Tax Rate Tables

TABLE 1 – Married Individuals Filing Joint Returns and Surviving Spouses

If Taxable Income is: The Tax is:

Not over $19,900 10% of the taxable income

Over $19,900 but not over $81,050 $1,990 plus 12% of the excess over $19,900

Over $81,050 but not over $172,750 $9,328 plus 22% of the excess over $81,050

Over $172,750 but not over $329,850 $29,502 plus 24% of the excess over $172,750

Over $329,850 but not over $418,850 $67,206 plus 32% of the excess over $329,850

Over $418,850 but not over $628,300 $95,686 plus 35% of the excess over $418,850

Over $628,300 $168,993.50 plus 37% of the excess over $628,300

TABLE 2 – Heads of Household

If Taxable Income is: The Tax is:

Not over $14,200 10% of the taxable income

Over $14,200 but not over $54,200 $1,420 plus 12% of the excess over $14,200

Over $54,200 but not over $86,350 $6,220 plus 22% of the excess over $54,200

Over $86,350 but not over $164,900 $13,293 plus 24% of the excess over $86,350

Over $164,900 but not over $209,400 $32,145 plus 32% of the excess over $164,900

Over $209,400 but not over $523,600 $46,385 plus 35% of the excess over $209,400

Over $523,600 $156,355 plus 37% of the excess over $523,600

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

If Taxable Income is: The Tax is:

Not over $9,950 10% of the taxable income

Over $9,950 but not over $40,525 $995 plus 12% of the excess over $9,950

Over $40,525 but not over $86,375 $4,664 plus 22% of the excess over $40,525

Over $86,375 but not over $164,925 $14,751 plus 24% of the excess over $86,375

Over $164,925 but not over $209,425 $33,603 plus 32% of the excess over $164,925

Over $209,425 but not over $523,600 $47,843 plus 35% of the excess over $209,425

Over $523,600 $157,804.25 plus 37% of the excess over $523,600

TABLE 4 – Married Individuals Filing Separate Returns

If Taxable Income is: The Tax is:

Not over $9,950 10% of the taxable income

Over $9,950 but not over $40,525 $995 plus 12% of the excess over $9,950

Over $40,525 but not over $86,375 $4,664 plus 22% of the excess over $40,525

Over $86,375 but not over $164,925 $14,751 plus 24% of the excess over $86,375

Over $164,925 but not over $209,425 $33,603 plus 32% of the excess over $164,925

Over $209,425 but not over $314,150 $47,843 plus 35% of the excess over $209,425

Over $314,150 $84,496.75 plus 37% of the excess over $314,150

TABLE 5 – Estates and Trusts

If Taxable Income is: The Tax is:

Not over $2,650 10% of the taxable income

Over $2,650 but not over $9,550 $265 plus 24% of the excess over $2,650

Over $9,550 but not over $13,050 $1,921 plus 35% of the excess over $9,550

Over $13,050 $3,146 plus 37% of the excess over $13,050

2. Standard Deductions

For taxable years beginning in 2021, the standard deduction amounts under Section 63(c)(2) are as follows:

Filing Status Standard Deduction

Married Individuals Filing $25,100

Joint Returns and Surviving

Spouses

Heads of Households $18,800

Unmarried Individuals (other $12,550

Than Surviving Spouses and

Heads of Households)

Married Individuals Filing $12,550

Separate Returns

3. Qualified Business Income Under Section 199A

For taxable years beginning in 2021, the threshold amount under Section 199(e)(2) is $329,800 for married filing joint returns, $164,925 for married filing separate returns, and $164,900 for single and head of household returns.

4. Basic Exclusion Amount

For an estate of any decedent dying in calendar year 2021, the basic exclusion amount is $11,700,000 for determining the amount of the unified credit against estate tax under Section 2010. The unified credit is $4,625,800.

5. Annual Exclusion for Gifts

(1) For calendar year 2021, the first $15,000 of gifts to any person (other than gifts of future interests in property) are not included in the total amount of taxable gifts under Section 2503 made during that year.

(2) For calendar year 2021, the first $159,000 of gifts to a spouse who is not a citizen of the United States (other than gifts of future interests in property) are not included in the total amount of taxable gifts under Section 2503 and 2523(i)(2) made during that year.

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

For an estate of a decedent dying in calendar year 2021, the dollar amount used to determine the "2-percent portion" (for purposes of calculating interest under Section 6601(j)) of the estate tax extended as provided in Section 6166 is $1,590,000.

* 1. **2020-2021 Priority Guidance Plan (November 17, 2020)**

**Treasury Department and Internal Revenue Service release their 2020-2021 Priority Guidance Plan**

On November 17, 2020, the Treasury Department and the Internal Revenue Service released their 2020-2021 Priority Guidance Plan which lists those projects which will be the focus of the IRS’s efforts during the twelve-month period from July 1, 2020 through June 30, 2021. The 2020-2021 Priority Guidance Plan contains 191 guidance projects of which guidance on 57 items had been released as of September 30, 2020.

The following items deal with guidance in the estate, gift, generation-skipping, fiduciary income tax, and related areas. Each item listed below is identified by the number given in the different parts of the Priority Guidance Plan.

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

4. Regulations clarifying the deductibility of certain expenses described in Sections 67(b) and (e) that are incurred by estates and non-grantor trusts. Final regulations were published on September 21, 2020.

This item was carried over from the 2019-2020 Priority Guidance Plan.

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

6. Guidance under Section 170(e)(3) regarding charitable contributions of inventory.

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

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

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

20. Guidance under Treas. Reg. §301.9100 regarding relief for late regulatory elections.

These items were carried over from the 2020-2021 Priority Guidance Plan.

Part 6. General Guidance. The section on gifts and estates and trusts in Part 6 includes the following items:

1. Guidance on the basis of grantor trust assets at death under Section 1014.
2. Guidance on the user fee for estate tax closing letters under Section 2001.

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

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

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

Items 2 and 4 are new. The other items were carried over from the 2019-2020 Priority Guidance Plan.

* 1. **Letter Rulings 2021027003 (Issued September 11, 2020; Released February 19, 2021); 202115001 (Issued November 3, 2020; Released April 16, 2021); 202116005 (Issued July 6, 2020; Released April 23, 2021);** **202120002 (Issued September 1, 2020; Released May 21, 2021); 20212007 (Issued October 21, 2020; Released May 21, 2021); 20213304 (Issued April 7, 2021; Released August 20, 2021)**

**Decedent’s estate granted extension to make portability election**

These letter rulings are some of the most recent numerous letter rulings with similar fact patterns in which the IRS has granted the estate of the first spouse to die an extension of time to make the portability election.

The facts of these letter rulings following this general pattern. Decedent died survived by spouse. Decedent’s estate was not required to file an estate tax return. Decedent had unused applicable exclusion and a portability election was necessary to allow the surviving spouse to take into account that unused applicable exclusion (DSUE amount). Since the availability of portability in 2011, the portability election is to be made on a timely filed complete and properly prepared estate tax return. Spouse’s tax advisor did not advise her about the portability election. Consequently, an estate tax return was not timely filed and the portability election was not made.

After the discovery of the missed portability election, decedent’s estate requested an extension of time under Treas. Reg. § 301.9100-3 to make the portability election. Treas. Reg. § 301.9100-3 provides that an extension of time to make an election when the due date is prescribed by a regulation (and not expressly provided by statute) will be granted when the taxpayer provides evidence to establish that the taxpayer acted reasonably and in good faith and that granting the relief will not prejudice the interests of the government. Because the time for filing the portability election is fixed by the regulations, the Internal Revenue Service had the discretionary authority under Treas. Reg. § 301.9100-3 to grant an extension of time.

Based on the information, affidavits, and representations submitted on behalf of the decedent’s estate, the Service granted the request for an extension of time. The Service did note that if it was later determined that decedent’s estate was large enough to require the filing of an estate tax return, the Service lacked the authority under Treas. Reg. § 301.9100-3 to grant an extension of time to elect portability. In that situation, the extension of time to elect portability would be deemed null and void.

* 1. **FR Document 2020-28931 (December 29, 2020)**

**Internal Revenue Service proposes $67 user fee for closing letter for federal estate tax returns**

The Internal Revenue Service on December 31, 2020 proposed amendments to Treas. Reg. § 300 to add a new Treas. Reg. § 300.13 to impose a $67 fee for the issuance of estate tax closing letters. The Service decided to impose a $67 user fee for closing letters because of resource constraints and because issuing closing letters is a convenience to the estates requesting them.

The Service issues estate tax closing letters to authorized persons such as an executor or an executor substitute upon the request of the authorized person only (i) after the Service has accepted the return as filed; (ii) after the estate has agreed to an adjustment; or (iii) after an adjustment in the deceased spousal unused exclusion (DUSE) amount.

The Service indicated its understanding of the important role of the acceptance of the estate tax return with respect to state and local requirements in the administration and closing of a probate estate, making final distributions, and avoiding potential personal liability for unpaid estate tax in making distributions. However, the Service also noted that an estate tax closing letter does not indicate whether the estate tax has been paid or the amount of the estate tax that has been paid.

Although a closing letter is not a formal closing agreement under Section 7121, pursuant to Rev. Proc. 2005-32, 2005-1 C. B. 1206, the Service will not reopen or examine the estate tax return after the issuance of a closing letter unless the estate notifies the Service of changes in the estate tax return or there is (i) evidence of fraud, malfeasance, collusion, concealment, or misrepresentation of a material fact, (ii) a clearly defined substantial error based upon an established IRS position, or (iii) a serious administrative omission. The closing letter does not limit or foreclose the IRS to making future adjustments to the DSUE amount shown on the estate tax return and the returns can be examined in the future for portability purposes. A closing letter also explains the potential applications of Sections 6166 and 6324A (installment payments and special extended lien), 2204 (discharge of personal liability, and 6324 (estate tax lien).

Prior to June 1, 2015, the Service generally issued an estate tax closing letter for each estate tax return filed. For returns filed on or after June 1, 2015, the Service only issues estate tax closing letters upon the request of an authorized person. The Service changed its position in 2015 for two reasons. First, because of portability, the number of estate tax returns filed increased at the same time that the Service faced “budget and resource constraints.” Second, the Service recognized that an account transcript with a transaction code and explanation of “421-Closed examination of tax return” is an available alternative to the closing letter. Prior to the COVID-19 pandemic, the authorized person could request a closing by letter or fax. Now, because of restrictions due to the COVID-19 pandemic, an authorized person can only request a closing letter by fax.

The Service noted that in 2016, the number of estate tax returns filed solely to elect portability of the DSUE amount was approximately 20,000 compared to the approximately 12,000 returns required to be filed because the estates equaled or exceeded that year’s basic exclusion amount of $5,450,000. In 2018, when the basic exclusion amount was $11, 180,000, approximately 30,500 returns were filed with a large number of returns filed solely to elect portability of the DSUE amount.

The Service determined the $67 amount of the user fee based upon the full cost of issuing closing letters for a year of $1,160,058 divided by an estimated volume of 17,249.

The Service has sought comments by March 1, 2021.

* 1. **Internal Revenue Service News Release, IR-2021-59 (March 17, 2021)**

**Government extends federal income tax filing due date for 2020 tax year to May 17, 2021**

On March 17, 2021, the Treasury Department and the Internal Revenue Service announced that the government was extending the federal income tax filing date for individuals for the 2020 tax year automatically to May 17, 2021. This date can be extended to October 15, 2021 by filing a request for an extension. The IRS was to supply further guidance in coming days. This was done in response to the “tough time for many people” and the desire of the IRS “to do everything possible to help taxpayers navigate the unusual circumstances related to the pandemic, while also working on important tax administration responsibilities.”

Individual taxpayers can also postpone federal income tax payments for the 2020 tax year due on April 15, 2021 to May 17, 2021. The relief does not apply to estimated payments due on April 15, 2021 for the 2021 tax year. The relief also does not apply to state income tax filing deadlines.

* 1. **Corporate Transparency Act (2021)**

**2021 National Defense Authorization Act requires many US and foreign entities to report beneficial owners**

In December 2020, President Trump vetoed the 2021 National Defense Authorization Act (NDAA). Congress then overrode this veto in January 2021. The NDAA enacted the Corporate Transparency Act (CTA), written within the scope of the Anti-Money Laundering Act of 2020 (AMLA). The CTA requires many U.S. entities and foreign entities qualified to do business in the U.S. to report their beneficial owners to the U.S. Department of Treasury’s financial intelligence unit, referred to as “FinCEN.” The CTA also requires FinCEN to maintain a federal database for this collected information. The CTA has broad implications on information reporting and for future financial transactions such as mergers, acquisitions, and special purpose vehicles.

The AMLA requires the Secretary of Treasury to issue regulations no later than January 1, 2022. Existing companies required to report under the CTA will have two years from the effective date of the regulations to make an initial report to FinCEN. Each reporting company formed after the effective date must make its initial report at the time of formation and within one year of any change in beneficial ownership.

Reporting Companies:The CTA defines a “reporting company” as a corporation, a limited liability company, or other similar entity formed under state law. In addition, a corporation, limited liability company, or other similar entity formed outside the U.S. that is registered to do business in the U.S. or in a state will also be considered a reporting company.

The CTA expressly exempts certain companies from the definition of a reporting company. Exemptions include the following entities, among others: publicly traded companies, tax-exempt entities, banks, pooled investment vehicles, and companies with a physical presence in the U.S. that employ more than 20 full-time employees and have more than $5,000,000 in gross receipts or sales (evidenced by a federal income tax return).

Beneficial Owners: The CTA defines “beneficial owner” to mean, with respect to an entity, an individual who, directly or indirectly, through any contract, arrangement, understanding, relationships, or otherwise, exercises “substantial control” over the entity or owns or controls not less than 25% of the “ownership interests” of the entity. Definitions for terms “substantial control” and “ownership interests” are expected to be provided in forthcoming regulations.

The CTA excepts certain beneficial owners from the reporting requirements, including: (i) a minor child (as defined in the state in which the entity is formed), if the information of the parent or guardian of the minor child is reported in accordance with the CTA, (ii) an individual acting as a nominee, intermediary, custodian, or agent on behalf of another individual, (iii) an individual acting solely as an employee of a reporting person and whose control over the economic benefits from such entity is derived solely from the employment status of the person, (iv) an individual whose only interest in a reporting company is through a right of inheritance, or (v) a creditor of a reporting person, unless the creditor meets the requirements of a “beneficial owner” based on substantial control or ownership or control of not less than 25% of the ownership interests.

Required Information: Each reporting company will be required to submit a report to FinCEN that includes the identity of each beneficial owner of the applicable reporting company and each applicant with respect to that reporting company. An “applicant” is a person who files an application to form an entity in the U.S. or to qualify a foreign entity to do business in the U.S. The report must include the following information with respect to a beneficial owner or applicant:

* Full legal name
* Date of birth
* Current residential or business address
* A unique identifying number from an acceptable identification document or a FinCEN identifier issued in accordance with the CTA

Although beneficial ownership information reported to FinCEN will remain in a secure and nonpublic database, such information may be accessed by certain authorized governmental authorities.

Penalties:The CTA provides for civil penalties (up to $500 per day) and criminal penalties (imprisonment of no more than 2 years) for those who willing provide false or fraudulent beneficial ownership information or willing fail to report completed or updated beneficial ownership information to FinCEN. There is a safe harbor exception for those who correct inaccurate information within 90 days of filing an inaccurate report.

The CTA is one of the most significant pieces of legislation created to combat terrorism financing, money laundering, and other financial crimes since the passage of the Patriot Act in 2001. Because of the new reporting regime created by the CTA, certain private wealth structures that had formerly been used to achieve estate and gift planning goals may be subject to additional compliance and administrative work. As the regulations are issued and deadlines for compliance draw near, financial advisors, attorneys, accountants, and other representatives of companies must be prepared to advice clients on this important new reporting responsibility.

**MARITAL DEDUCTION**

* 1. **Letter Ruling 202115002 (Issued November 3, 2020; Released April 16, 2021)**

**Estate granted extension of time to make QTIP election**

The first spouse died leaving the residue of her estate in a marital trust for the benefit of the surviving spouse. The trust document provided that the marital trust property was to be treated as QTIP property for federal and state death tax purposes if the executor made the necessary election to do so.

The surviving spouse, as the personal representative, retained an accountant to prepare the Form 706 (Estate Tax Return). A CPA firm prepared the Form 706. The Form 706 reported the marital trust assets as “all other property” on Schedule M and reported no QTIP property. A marital deduction was claimed for all property After the filing of the Form 706, the CPA firm discovered the mistake. As a result, the spouse requested an extension of time to make a QTIP election for the marital trust.

Treas. Reg. § 301.9100-1(c) gives IRS the discretion to grant a reasonable extension of time for a regulatory election. Under Treas. Reg. § 301.9100-3, a request for an extension of time will be granted when the taxpayer shows that the taxpayer acted reasonably and in good faith and that granting the relief will not prejudice the interests of the government. A taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional and the tax professional failed to make or advise the taxpayer to make an election.

The IRS found that the requirements of Treas. Reg. § 301.9100-3 had been satisfied and granted an extension of time for the estate to make the QTIP election for the marital trust.

* 1. **Letter Ruling 202133010 (Issued April 8, 2021; Released August 20, 2021)**

**IRS grants extension of time to make QTIP election**

A married couple lived in a community property state. The first spouse’s estate plan used both a will and revocable trust. Upon the first spouse’s death, a marital deduction trust was created which was to be funded with some of the first spouse’s separate property and the first spouse’s one-half interest in the community property. The first spouse’s intention, as stated in the terms of his will and revocable trust, was for the trustee or the executor to make the QTIP election for the marital trust.

The surviving spouse served as the sole trustee of the trust and sole executor of the estate. Nine months later, child became the sole trustee of the trust and sole executor of the estate. The spouse and the child retained an accountant to prepare the Form 706. The accountant prepared both a Form 706 and supplemental Form 706. Although the due date for filing the Form 706 was extended by six months, neither the Form 706 nor the supplemental Form 706 was timely filed and no QTIP election was made for the marital trust.

An attorney whom the surviving spouse subsequently retained for estate planning advice discovered the failure to make the QTIP election. An extension of time under Treas. Reg. § 301.9100-3 to make a QTIP election for the marital trust was requested.

The Service granted the request. Under Treas. Reg. § 301.9100-3, a request will be granted when the taxpayer shows that the taxpayer acted reasonably and in good faith and that granting relief will not prejudice the interests of the government. A taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional and the tax professional failed to make or advise the taxpayer to make the election. The IRS concluded that these requirements were satisfied.

* 1. **Estate of Grossman v. Commissioner, T.C. Memo 2021-65**

**Tax Court recognizes religious divorce and Israeli marriage and allows estate tax marital deduction for property passing to surviving spouse**

This matter came before the court on cross motions for partial summary judgment. The issue was whether Ziona Grossman was the surviving spouse of Semone Grossman for purposes of the estate tax marital deduction. Semone and Ziona, both Jewish and residents of New York, celebrated their marriage in Israel in 1987 pursuant to Israeli laws after Semone obtained a religious divorce from his first wife Hilda, who was also Jewish and a New York resident. After their marriage, Semone and Ziona returned to New York, had two daughters, and lived together as husband and wife for twenty-seven years until Semone’s death in 2014.

Semone and Hilda were married in 1955. In 1967, Semone began a new relationship with Katia, who was not Jewish, and obtained a divorce in Mexico in which Hilda neither appeared nor participated. In 1974, after Semone’s and Katia’s relationship had ended, Hilda challenged the validity of the Mexican divorce in New York state court. The New York court declared that Hilda’s marriage to Semone was not legally dissolved and that the marriage of Semone with Katia was null and void.

Later, Semone met Ziona. In 1986, before Semone married Ziona, Hilda agreed with Semone to him giving her a *get* which is a religious divorce under rabbinical law and which was granted. In 1987, Semone and Hilda were married in Israel in an Orthodox Jewish religious ceremony and issued a marriage certificate by the Israeli Ministry of Religious Services.

After their marriage, Semone and Ziona filed joint income returns. When he died in 2014, Semone was buried in Israel alongside Ziona’s parents. Semone in his will directed that any reference to “my wife” meant Ziona.

Hilda lived in New York until her death in 2014. Hilda on her federal income tax returns listed herself as single. Hilda never challenged Semone’s marriage to Ziona. Upon Semone’s death in New York in 2014, Hilda made no statutory claim against his estate as a surviving spouse.

Semone had a large estate which was valued at approximately $87 million on a gross basis. The bulk of the estate ($79 million) was left to Ziona.

The Internal Revenue Service, in the audit of Semone’s federal estate tax return, determined that Semone and Ziona were not married to each other for federal estate tax purposes and that the amounts left to Ziona failed to qualify for the estate tax marital deduction. The IRS asserted that Semone’s estate owed an additional $35,497,032 in federal estate tax and imposed an accuracy related penalty under Section 6662 of $7,099,406.

The court ruled that Semone and Ziona were properly married. The court focused on Semone’s and Ziona’s marriage and said that New York law would recognize Semone’s and Ziona’s marriage if it was lawful under the laws of the place in which marriage was celebrated which in this case was Israel. Israel had recognized the marriage as lawful.

The court quoted the oft-expressed concern that “Congress did not intend that the Commissioner in making tax determinations around marital status, or the courts in passing upon them, should set themselves up as domestic relations tribunals.” Estate of Borax v. Commissioner, 349 F.2d 666, 676 (2d Cir. 1965) (Friendly, J. dissenting). It noted that the parties most interested in the status of Semone and Ziona’s marriage, Semone, Ziona, and Hilda, did not challenge the marriage. No New York court (or any other court) found the marriage invalid. As a result, the court was not going to assume, based on the facts presented, that Semone and Ziona were not husband and wife under New York law. As a result, the court granted the estate’s motion for partial summary judgment and denied the IRS’s motion for partial summary judgment.

* 1. **Letter Ruling 202120004 (Issued September 10, 2020; Released May 21, 2021)**

**IRS grants extension of time to file the necessary form to notify IRS that beneficiary of qualified domestic trust had become United States citizen**

The surviving spouse was not a U.S. citizen at the time of the first spouse’s death and the surviving spouse received an outright distribution. After the decedent’s death, the spouse established and funded a qualified domestic trust (QDOT) to hold the assets that she received outright from the decedent. After the funding of the QDOT, the spouse became a U.S. citizen.

The original co-trustees of the QDOT were the son and an individual U.S. citizen. The QDOT named Bank 1 as a successor co-trustee in the event of a death of an original co-trustee. Two events occurred prior to the spouse becoming a U.S. citizen. Son died and Bank 2, as the successor to Bank 1, took possession of the QDOT assets. The individual U.S. trustee believed that Bank 2 as successor co-trustee was handling all administrative matters for the QDOT, including tax matters. However, Bank 2 did not accept appointment as co-trustee of the QDOT and the individual U.S. trustee was the sole trustee of the qualified domestic trust after the son’s death.

The individual U.S. trustee lacked experience in U.S. estate tax matters and was unaware of the need to provide notification and certification of the spouse’s U.S. citizenship. Consequently, neither the required Form 706 (QDT) to terminate the QDOT nor an extension of time for filing the Form 706 (QDT) was ever filed.

Upon discovering the failure to file the necessary form, the individual U.S. trustee submitted a request for an extension of time to file the return.

Treas. Reg. § 9100-3 provides that the IRS should grant relief if the taxpayer acted reasonably and in good faith and that the granting of relief will not prejudice the interests of the government. A taxpayer is deemed to have acted reasonably and in good faith if the taxpayer failed to make an election because, after exercising reasonable diligence (taking to account the taxpayer’s experience and the complexity of the return or issue), the taxpayer was unaware of the need of the election. The IRS determined that this standard was met and an extension of time to file the required notice and certification that the spouse had become a United States citizen was allowed.

**GIFTS**

* 1. **Letter Rulings 202016002 through 202016006 (Issued October 30, 2019; Released April 17, 2020)**

**Service rules on matters arising from settlement of surviving spouse’s challenge to decedent’s will**

In these five similar letter rulings, the IRS ruled on matters involving a set of trusts that entered into a settlement agreement to resolve the surviving spouse’s challenge to the decedent’s will. Prior to Decedent's death, Decedent and Spouse were living apart and became estranged. After Decedent's death, Bank opened Decedent's probate estate in the local probate court. Spouse filed a Petition for Revocation in the probate court challenging Decedent's will on grounds of lack of testamentary capacity and undue influence by the Bank. Subsequently, the parties filed actions in two circuit courts.

After substantial litigation, the parties entered into a Settlement Agreement. The primary purpose of the Settlement Agreement was to terminate an Irrevocable Trust created for Spouse and a Marital Trust and to preserve the trust funds to meet Decedent's intent to provide for Spouse and Charitable Trust.

The IRS granted the requested rulings regarding the following:

(1) The entire Irrevocable Trust constitutes qualified terminable interest property (QTIP) under tax code Section 2523(f), as does the entire Marital Trust (as divided into a GST Exempt Marital Trust and a GST Non-Exempt Marital Trust), under Section 2056(b)(7)(B).

(2) A “principal distribution” from the Irrevocable Trust to Spouse for maintenance and support doesn’t constitute a disposition under Section 2519 (regarding treatment of dispositions as transfer of trust interests other than qualifying income interest) by Spouse;

(3) Spouse’s proposed transfer of her qualifying income interests in the Irrevocable Trust, GST Exempt Marital Trust, and GST Non-Exempt Marital Trust will constitute dispositions to which Section 2519 applies and will not result in gifts by Spouse, because she will receive the present value of such interests.

(4) Spouse’s transfer of her trust interests, other than qualifying income interests, to Charitable Trust will result in gift tax deductions for her under Section 2522, assuming that trust meets the description in Section 2522(a).

(6) Spouse’s disclaimer of her remote contingent remainder interests in three Individual Trusts will not result in any gifts by her, because she received full and adequate consideration of those interests.

(7) The termination of the Irrevocable Trust, GST Exempt Marital Trust, and GST Non-Exempt Marital Trust will result in Spouse making a deemed gift of the entire fair market value of the assets therein, which won’t be includible in her gross estate.

(8) The indirect exchange between Spouse — as a substantial contributor to Charitable Trust and as a family member of its creator — and Charitable Trust will not constitute “self-dealing” under Section 4941, because the term does not apply to a transaction between a private foundation and a disqualified person where such status arises only as a result of such transaction.

* 1. **T. D. 9889 -- Final Regulations on Inclusion Events for Qualified Opportunity Funds (December 19, 2019)**

**IRS issues final regulations on Qualified Opportunity Funds**

An Opportunity Fund is an investment vehicle, which is intended to invest in real estate in “Opportunity Zones.” In turn, Opportunity Zones are specific geographic areas designated as economically distressed. Tax incentives for investments in Opportunity Zones include delayed and potentially reduced taxes on capital gains. Opportunity zones were created as part of the 2017 Tax Act through the creation of a new Subchapter Z, which contains two new sections, 1400Z-1 and 1400Z-2. They are intended to encourage investment in underfunded, low-income and distressed communities that are designated by the states and subsequently certified by the Secretary of the Treasury. A Qualified Opportunity Fund must invest at least ninety percent of its assets in designated opportunity zones to receive the preferential treatment.

An individual who has sold appreciated property may defer recognition of the resulting capital gain (currently through December 31, 2026) by investing the gain in a Qualified Opportunity Fund within 180 days. The basis of the individual in the Qualified Opportunity Fund is initially zero and increases by ten percent of the original deferred gain after five years, and by another five percent after seven years. Under current law, on December 31, 2026, the gain will be recognized and the investor’s basis in the fund will be stepped up to the amount of the original gain that was invested in the fund. A provision of Section 1400Z-2 provides a way in which an investor can avoid the recognition of all gain and use the fair market as basis by holding the investment for ten years (which is beyond the December 31, 2026 date).

Proposed regulations were issued in May 2019 and final regulations were issued on December 19, 2019 and published in the Federal Register on January 13, 2019. These regulations took effect on March 13, 2020, for taxable years beginning after that date.

The regulations provide that the deferred gain will be accelerated because of an “inclusion event” with respect to an individual’s interest in a Qualified Opportunity Fund. The final regulations provide that an event is an inclusion event if it “reduces an eligible taxpayer’s direct equity interest for federal income tax purposes in the qualifying investment.” Consequently, under this broad definition, the transfer during life of a qualifying investment by gift will be an inclusion event that accelerates the capital gain. On the other hand, the final regulations provide that a transfer of a qualifying investment because of the death of the individual will not be an inclusion event. Transfers by reason of death include:

1. Transfer to a deceased owner’s estate as a result of a deceased owner’s death;
2. A distribution of a qualifying investment by a deceased owner’s estate;
3. A distribution of a qualifying investment by a deceased owner’s trust as result of the death of the deceased owner;
4. The passing of a jointly-owned qualifying investment to the surviving co-owner or co-owners by operation of law; and
5. Any other transfer of a qualifying interest by operation of law upon the death of the deceased owner.

The rules on transfers at death do not apply to a sale or other disposition by a deceased owner’s estate or trust or any disposition by a recipient of the qualifying investment upon the death of the deceased owner.

The inclusion event rules do not apply to contributions to grantor trusts. See Treas. Reg. § 1.1400Z2(b)-1(c)(5)(i). The exception appears to apply to all grantors including trusts treated as grantor trusts under the deemed owner rules for third parties of Section 678. The exception also applies to transfers from the grantor trust to the deemed owner, be it the actual grantor or a third party.

* 1. **Cavallaro v. Commissioner, T.C. Memo 2014-189; 842 F.3d 16 (1st Cir. 2016), aff’g in part, rev’g in part and remanding; and T.C. Memo 2019-144**

**Tax Court holds that husband and wife are liable for gift tax following company merger, but reduces amount of additional gift upon remand from First Circuit Court of Appeals**

In 1979, Mr. and Mrs. Cavallaro started Knight Tool Company. Knight was a contract manufacturing company that made tools and machine parts. In 1982, Mr. Cavallaro and his eldest son developed an automated liquid dispensing machine they called CAM/ALOT. Subsequently, in 1987, Mr. and Mrs. Cavallaros’ three sons incorporated Camelot Systems, Inc., which was a business dedicated to the selling of the CAM/ALOT machines made by Knight. The two companies operated out of the same building, shared payroll and accounting services, and collaborated in the further development of the CAM/ALOT product line. Knight funded the operations of both companies and paid the salaries and overhead costs for both.

In 1994, Mr. and Mrs. Cavallaro sought estate planning advice from a big four accounting firm and a large law firm. The professionals advised Mr. and Mrs. Cavallaro that the value of CAM/ALOT Technology resided in Camelot (the sons’ company) and not in Knight and that they should adjust their estate planning. Mr. and Mrs. Cavallaro and their three sons merged Knight and Camelot in 1995 and Camelot was the surviving entity. Part of the reason for the merger was to qualify for Conformite Europeenne, which means European conformity, so that the CAM/ALOT machines could be sold in Europe. In the 1995 merger, Mrs. Cavallaro received 20 shares, Mr. Cavallaro received 18 shares, and 54 shares were distributed to the three sons. In valuing the company, the accounting firm assumed that the premerger Camelot had owned the CAM/ALOT technology. The Tax Court found that Camelot had not owned the CAM/ALOT technology, and as a result, the Tax Court found that the appraiser overstated the relative value of Camelot and understated the relative value of Knight at the time of the merger.

In 1996, Camelot was sold for $57 million in cash with a contingent additional amount of up to $43 million in potential deferred payments based on future profits. No further payments were made after the 1996 sale. Three issues were under review by the tax court:

1. Whether the 19 percent interest received by Mr. and Mrs. Cavallaro in Camelot Systems, Inc., in exchange for their shares of Knight Tool Company in a tax free merger, was full and adequate consideration, or whether it was a gift.

2. Whether Mr. and Mrs. Cavallaro were liable for additions to tax under Section 6651(a)(1) for failure to file gift tax returns for 1995, or whether the failure was due to reasonable cause.

3. Whether there were underpayments of gift tax attributable to the gift tax valuation understatement for purposes of the accuracy related penalty, or whether any portions of the underpayment were attributable to reasonable cause.

With respect to the valuation issue, the Cavallaros offered two experts regarding the value of the combined entity. One expert valued the entity at between $70 million and $75 million and opined that only $13 million to $15 million of that value was attributable to Knight. A second appraiser valued the combined entity at $72.8 million.

The IRS retained its own appraiser, Marc Bello of Edelstein & Company. Bello assumed that Knight owned the CAM/ALOT technology. He valued the combined entities at approximately $64.5 million and found that 65 percent of that value, or $41.9 million, was Knight’s portion.

In reaching its decision on the gift tax liability, the Tax Court noted that the 1995 merger transaction was notably lacking in arm’s-length characteristics and Camelot may have been a sham company. It also discussed how the law firm in 1995 had tried to document the ownership of the CAM/ALOT technology by the sons but that such documentation was insufficient. The Court did not accept the testimony of the accounting firm. It noted that the IRS had conceded during the litigation that the value of the combined entities was not greater than $64.5 million and that the value of the gift made in the merger transaction was not greater than $29.6 million. As a result, the Tax Court concluded that Mr. and Mrs. Cavallaro made gifts totaling $29.6 million in 1995.

The Tax Court rejected the imposition of penalties for failure to file a gift tax return and accuracy-related penalties. It found that in both instances, Mr. and Mrs. Cavallaro had been advised by an accountant or lawyers and that there was reasonable cause for the failure to file a gift tax return and failure to pay the appropriate amount of tax. It noted that Mr. and Mrs. Cavallaro relied on the judgment and advice of the professional advisors and that the CAM/ALOT technology had been owned by the sons’ company since 1987 (and thus was not being transferred in 1995). In documenting its finding of reasonable cause to avoid the penalties, the Tax Court went into great detail about Mr. and Mrs. Cavallaros lack of formal education beyond high school and that they had built the business themselves.

In their appeal, Mr. and Mrs. Cavallaros argued that the Tax Court erred in three respects:

1. Its failure to shift the burden of proof to the IRS;
2. Concluding that Knight owned the intangible assets (the CAM/ALOT technology); and
3. Misstating the Cavallaros’ burden of proof and failing to consider flaws in the opinion offered by Marc Bello.

The First Circuit Court of Appeals in 2016 held that the Tax Court was correct in not shifting the burden of proof to the IRS and that Knight owned the intangibles including the CAM/ALOT technology. The First Circuit remanded the case to the Tax Court on the issue of the Tax Court’s failure to accept the Cavallaros’ argument that the IRS’s valuation was “arbitrary and excessive” by challenging Bello’s methodology. The Tax Court had refused to hear that challenge on the grounds that, even if the Cavallaros were correct, they were unable to show the correct amount of their tax liability. The First Circuit held that the Tax Court should evaluate the Cavallaros’ argument that Bello’s appraisal contained methodological flaws that made arbitrary and excessive.

The Tax Court on remand rejected all but one of the Cavallaros’ arguments with respect to Bello’s appraisal. The Tax Court first found that Bello’s failure to interview the principals of Knight and Camelot and his failure to do a site visit did not cause him to misunderstand the nature of the business of each of Knight and Camelot. The Tax Court also rejected the Cavallaros’ challenges of Bello’s profit reallocation calculation and discounted cash flow calculation. The Tax Court did find that Bello’s placement of Camelot in the 90th percentile of similar businesses was based on a statistically unreliable method and was incorrect. Instead, Camelot should have been in the 88.3d percentile and this would make a significant difference in valuation. This reduced the rounded value of the gift by $6.9 million from $29.6 million to $22.8 million.

* 1. **Revenue Procedure 2021-3, 2021-1 IRB 140 (January 4, 2021)**

**Service states that it will not issue rulings on consequences of incomplete non-grantor trusts**

In Item (17) of Section V of Revenue Procedure 2021-3, the Internal Revenue Service stated that it would no longer issue letter rulings with respect to incomplete gift non-grantor trusts which are sometimes referred to as “INGS,” “DINGS” (if set up under Delaware law), or “NINGS” (if set up under Nevada law) when it added incomplete gift non-grantor trusts to the areas that under study. Letter rulings will only be issued when the Service resolves the issue through the publication of a revenue ruling, revenue procedure, regulation, or otherwise.

Previously, in Revenue Procedure, 2020-3, 2020-1 IRB 131 (January 2, 2020), the Service stated that it will not issue letter rulings with respect to beneficiary incomplete non-grantor trusts if the proposed trusts did not follow the provisions set forth in those trusts which the Service had approved in prior letter rulings.

An ING is structured to be a non-grantor trust for income tax purposes that is funded by transfers from the grantor that are incomplete gifts for gift tax purposes. Assuming the trust is established in a state that doesn’t tax the income accumulated in the trust (such as Delaware or Nevada), the trust will avoid state income taxes as long as the state of residence of the grantor or beneficiaries doesn’t subject the trust’s income (or accumulated income) to tax. Moreover, if structured and administered properly, the trust property should be protected from the grantor’s creditors.

The ING allows a grantor to achieve both of these benefits while still being able to receive discretionary distributions of trust property and without paying gift tax (or using any gift tax exemption) on the transfer of property to the trust. A gift from the grantor will be complete upon a subsequent distribution from the trust to a beneficiary other than the grantor, and whatever property remains in the trust will be subject to estate tax at the grantor’s death.

An ING is particularly attractive for a highly appreciated asset in anticipation of sale of that asset. For example, the founder of a business that is going to be sold may face hundreds of thousands or even hundreds of millions of dollars of capital gain because he or she has so little basis. Avoiding state income tax on those gains can be a significant benefit.

Letter Ruling 202017018 (issued November 29, 2019; released April 24, 2020) is a recent example of many letter rulings with similar facts on the tax consequences of an incomplete non-grantor trust. Previous rulings on this subject include Letter Ruling 201836006 (issued May 30, 2018; released September 2018) and Letter Ruling 202014001 (issued August 26, 2019; released April 3, 2020).

In Letter Ruling 202017018, grantor created an irrevocable trust. The beneficiaries were grantor, grantor’s spouse, grantor’s issue, grantor’s parents, and other issue or grantor’s parents. A corporate trustee was the sole trustee of the trust.

The trust created a distribution committee. The distribution committee was initially composed of the grantor, grantor’s spouse, grantors parents, and grantor’s sister. Until the death of the grantor, the distribution committee was to have at least two members, other than grantor or grantor’s spouse.

Under the terms of trust, the trustee was to distribute income and principal of the trust as directed by the distribution committee, grantor, or both as follows:

1. Grantor’s Consent Power. Income or principal to any beneficiary other than the grantor’s spouse as determined by a majority of the distribution committee, other than grantor or grantor’s spouse, acting in a non-fiduciary capacity with the written consent of grantor.
2. Unanimous Committee Power. Income or principal to any beneficiary as determined by the unanimous decision of the distribution committee, other than grantor or grantor’s spouse, acting in a non-fiduciary capacity.
3. Grantor’ Sole Power. Principal to any beneficiary other than grantor or grantor’s spouse as determined by grantor acting in a non-fiduciary capacity for the support, health, or education of a beneficiary.

Grantor held a testamentary power of appointment to the issue of grantor’s parents (other than the grantor, his estate, or the creditors of either); grantor’s spouse, or one or more charitable organizations. The balance not effectively appointed by grantor upon his death would be distributed to a designated trust.

The taxpayer sought the following rulings:

1. During the period that the distribution committee was serving, there would be no income tax consequences to the grantor or any member of the distribution committee under the grantor trust rules.
2. The grantor’s contribution of property of the trust was not a completed gift subject to federal gift tax.
3. Any distribution of property from the trust by the distribution committee to the grantor was not a completed gift for gift tax purposes by a member of the distribution committee to the grantor.
4. Any distribution of property by the distribution committee from the trust to any beneficiary of the trust other than the grantor was not a completed gift for gift tax purposes by any member of the distribution committee to that beneficiary.
5. No member of the distribution committee would be deemed to have a taxable general power of appointment pursuant to Section 2041 or Section 2514 upon his or her death.

The Service first ruled that none of the provisions of the trust would cause the grantor to be treated as the owner of the trust for income tax purposes under any of Sections 673, 674, 676, 677, 678, or 679 as long as the distribution committee remained in existence and was serving and the trust was a domestic trust.

The Service stated that examination of the trust revealed none of the circumstances that would cause administrative controls to be considered exercisable primarily for the benefit of the grantor under Section 675. A determination of whether Section 675 would cause the grantor to be treated as the owner of any portion of the trust for income tax purposes was deferred until the federal income tax returns of the trust were examined.

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

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

* 1. **James C. Nelson v. Commissioner, T.C. Memo 2020-81**

**Tax Court finds that formula for gift, sale of limited partnership interests at a discount is not a defined value formula, and additional gift tax is imposed**

This case was consolidated with the case of Mary P. Nelson v. Commissioner. Husband and Wife, James and Mary Nelson, formed Longspar Partners, Ltd. as a Texas limited partnership on October 1, 2008. The stated purposes for creating Longspar Partners were:

(1) to consolidate and protect assets;

(2) to establish a mechanism to make gifts without fractionalizing the interest; and

(3) to ensure that the underlying entity, Warren Equipment Company (“WEC”), remained in business and under the control of the Warren family.

WEC, in turn controlled several businesses established by Mrs. Nelson’s father in construction equipment and oil-related businesses. Mrs. Nelson and custodial accounts and trusts for descendants contributed 65,837 WEC shares (approximately 27 percent of the WEC common stock) to Longspar Partners in addition to some other assets. Mrs. Nelson’s siblings and others held the remaining WEC shares.

After the creation of Longspar Partners, Mr. and Mrs. Nelson each held ½ of the one percent general partner interest. Mrs. Nelson held 93.88 percent of the limited interests. The remaining interests were held in the custodial accounts or trusts for descendants.

On December 23, 2008, Mr. and Mrs. Nelson created the Nelson 2008 Descendants Trust of which Mrs. Nelson was the settlor and Mr. Nelson was the trustee as well as being a beneficiary with the couple’s four daughters. On December 31, 2008, Mrs. Nelson gifted Longspar limited partnership interests to the trust. The Memorandum of Gift stated:

[Mrs. Nelson] desires to make a gift and to assign to … [the Trust] her right, title, and interest in a limited partner interest having a fair market value of TWO MILLION NINETY-SIX THOUSAND AND NO/100THS DOLLARS ($2,096,000.00) as of December 31, 2008… as determined by a qualified appraiser within ninety (90) days of the effective date of this Assignment.

Subsequently, on January 2, 2009, Mrs. Nelson sold Longspar limited partnership interests to the 2008 Descendants Trust. The Memorandum of Sale provided that she was transferring limited partnership interests having a fair market value of $20,000,000 as of January 2, 2009 as determined by a qualified appraiser within 180 days of the effective date of the assignment. Neither the Memorandum of Gift nor the Memorandum of Sale contained clauses defining fair market value or subjecting the limited partner interests to reallocation after the valuation date. In connection with the second transfer, the trust executed a promissory note for $20,000,000 as consideration for the Longspar limited partnership interests purchased by the 2008 Descendants Trust.

Subsequently, Mr. and Mrs. Nelson retained a qualified appraiser to value the Longspar limited partnership interests in connection with both the 2008 gift and the 2009 sale. The appraiser concluded that as of the dates of the gift and the sale, the value of a one percent limited partnership interest in Longspar was $341,000. As a result, the appraiser calculated that Mrs. Nelson gave 6.14 percent of her Longspar limited partnership interests (value of $2,093,740) to the trust on December 31, 2008 and sold 58.65 percent of her Longspar limited partnership interests (value of $19,999,650) on January 2, 2009. Thus, a total of 64.79 percent of Mrs. Nelson’s 93.88 percent Longspar limited partnership interests were given or sold to the 2008 Descendants Trust.

Subsequently, the Internal Revenue Service reviewed Mr. and Mrs. Nelson’s 2008 and 2009 gift tax returns. On the 2008 gift tax returns, each reported a gift to the trust and classified it as a split gift so that each was responsible for half the gift. The couple did not report the January 2, 2009 sale of the limited partnership interests on the 2009 gift tax returns since it was a sale.

Subsequently, the IRS on audit determined that the 2008 gift was undervalued and that there was a gift tax deficiency of $611,708 for the 2008 gift. Likewise, the IRS imposed a gift tax deficiency of $6,123,168 for the 2009 sale because of the undervaluation of the Longspar partnership interests. The IRS also imposed accuracy related penalties under Section 6662(a) but conceded these penalties in the litigation.

On the basis of settlement discussions with IRS Appeals, Mr. and Mrs. Nelson amended Longspar’s partnership agreement to record the 2008 Descendants Trust’s interest as 38.55 percent rather than 64.79 percent.

The issues for the court were whether Mr. and Mrs. Nelson had used a defined value formula in which case there would be no adverse gift tax consequences and if they had not, what was the value of the interest that was transferred.

Mr. and Mrs. Nelson argued that the transfer documents showed that Mrs. Nelson transferred specific dollar amounts of Longspar limited partnership interests and not fixed percentages citing Wandry v. Commissioner, T.C. Memo 2012-88; Hendrix v. Commissioner, T.C. Memo 2011-133; Estate of Petter v. Commissioner, T.C. Memo 2009-280; and McCord v. Commissioner, 461 F.3d 614 (5th Cir. 2006). The court disagreed. It noted that the interests transferred in this case were expressed as an interest having a fair market value of a specific dollar amount as determined by an appraiser within a fixed period. As a result, the value depended on the determination by an appraiser within that fixed period. The definition of value was not further qualified, for example, as that finally determined for federal gift tax purposes. Such a further qualification was found in Estate of Christensen v. Commissioner, 130 T.C. 1 (2008) aff’d. 586 F.3d 1061 (8th Cir. 2009). The clause in that case stated that fair market value would be “as such value is finally determined for federal estate tax purposes.” Similarly, in Petter, the clause referenced the amount that can pass free of federal gift tax as finally determined for federal gift tax purposes. As a result, the court concluded that Mrs. Nelson transferred to the trust a 6.14 percent limited partnership interest by gift and a 58.35 percent limited partnership interest by sale, as determined by a qualified appraiser within a fixed period.

The court then, in a lengthy discussion of valuation, first had to decide what discount should be applied to the WEC common stock held in Longspar Partners. The estate’s appraiser had valued the WEC common stock at $860 per share while the IRS’s appraiser valued the WEC common stock at $1,072 per share. The court determined that a 15 percent discount for lack of control and a 30 percent discount for lack of marketability should apply. This resulted in a fair market value of $912 per share. The court then applied a discount of 5 percent for lack of control and 28 percent discount for lack of marketability to calculate the fair market value of a Longspar limited partnership interest and determined that the value of a one percent Longspar limited partnership interest was $411,235. As a result, Mrs. Nelson made a gift of Longspar limited partnership interests having a value of $2,524,983 in 2008 ($428,983 more than reported on the 2008 gift tax return) and sold Longspar limited partnership interests having a value of $24,118,933 resulting in a gift in 2009 of $4,118,933.

* 1. **Grieve v. Commissioner, T.C. Memo 2020-28**

**Court accepts donor’s valuation for nonvoting LLC interests transferred to grantor retained annuity trust and irrevocable gift trust**

Pierson Grieve was a successful businessman who ended his career as the Chairman and Chief Executive Officer of EcoLab, Inc., a publicly traded corporation. Pierson engaged in estate planning starting in the late 1980’s or the early 1990’s, which included the creation of a family limited partnership of which Pierson M. Grieve Management Corp. (PMG) was the General Partner. Pierson consolidated the management of his assets in PMG.

In 2008, Pierson’s daughter, Margaret, purchased PMG and became its sole owner and president. In 2012, Pierson and his wife, Florence, engaged a law firm to review and update their estate plan. Florence died in 2012 before the finalization of the updated estate plan.

Margaret worked with the law firm to develop and implement the updated estate plan. In 2012, Pierson created an irrevocable trust for the benefit of his children with South Dakota Trust Company as trustee (2012 Irrevocable Trust).

Part of the update of the estate plan also included the creation of two limited liability companies. Florence and PMG formed Angus LLC in August 2012. PMG had all Class A voting units representing 0.2 percent of Angus and Florence had all Class B nonvoting units representing 99.8 percent of Angus. The assets of Angus included a brokerage account with cash and short-term investments, limited partnership interests, investments in venture capital funds, and promissory notes. The value of the assets in Angus on the date of its creation was $31,970,683. Florence transferred all her Angus interests to Pierson approximately one month after the creation of Angus.

Pierson’s revocable trust, of which Margaret was the trustee, and PMG formed Rabbit LLC in July 2013. PMG had all Class A voting units representing 0.2 percent of Rabbit and Pierson’s revocable trust held all nonvoting Class B units representing 99.8 percent of Rabbit. The two major assets of Rabbit were 82,984 EcoLab shares and $1,000,000 in cash. The value of the Rabbit assets on October 9, 2013 was $9,102,757

On October 6, 2013, Pierson and Margaret, as trustee of Pierson’s revocable trust, created a zero-out Grantor Retained Annuity Trust (GRAT) that provided for the payment of an increasing annuity over two years. The first annuity payment was equal to 47.14757 percent of the fair market value of the assets contributed and the second annuity payment was equal to 56.57708 percent of the fair market value of the assets contributed. The GRAT was funded with all 9,980 Class B nonvoting units of Rabbit. Pierson valued the Class B Rabbit nonvoting units at $5,903,769 as of the date of the gift. This represented a 13.4 percent lack of control discount and a 25 percent lack of marketability discount which, when combined, produced a 35.0 percent discount. Valuation Consulting Group prepared the valuations for the gift tax return.

On November 1, 2013, Pierson, individually, and South Dakota Trust Company, as trustee of the irrevocable gift trust, entered into a single life private annuity agreement. Pierson assigned all of his 9,980 Class B nonvoting Angus interests to the 2012 Irrevocable Trust in exchange for annual annuity payments of $1,420,000. The private annuity had a fair market value of $8,043,675. Pierson intended to make a net taxable gift to the extent that the fair market value of the Class B nonvoting Angus interests exceeded the value of the annuity. Pierson valued the Class B Angus nonvoting interests at $20,890,934 for gift tax purposes. This represented a 12.7 percent lack of control discount and a 25 percent lack of marketability discount which, when combined, produced a 34.5 percent discount. The value of the net gift was $9,966,659.

On January 29, 2018, the IRS issued a Notice of Deficiency which increased the value of the 9,980 Class B Rabbit nonvoting units transferred to the GRAT from $5,903,769 to $9,048,866 (a 0.4 percent discount). The IRS increased the value of the 9,980 Class B nonvoting Angus units transferred to the 2012 Irrevocable Trust from $20,890,934 to $31,884,403 (a 0.1 percent discount). This increased the value of the net gift from $9,966,659 to $17,819,139.

The Tax Court stated that the hypothetical willing buyer-willing seller test applies to the valuation of the transferred Rabbit and Angus units. Pierson submitted valuations of Rabbit and Angus prepared by Will Frazier to the court. Using a combination of the market approach and the income approach, Frazier concluded that the Class B nonvoting Rabbit interests transferred to the GRAT on a noncontrolling nonmarketable basis were worth $5,884,000 (a 35.0 percent discount). Frazier also concluded that the Class B nonvoting Angus interests transferred to the 2012 Irrevocable Trust on a noncontrolling nonmarketable basis were worth $19,854,000 (a 37.8 percent discount).

The IRS’s appraiser, Mark Mitchell, took a different approach. Mitchell concluded that any willing seller of the Class B nonvoting units in Rabbit and Angus would look to acquire the 0.2 percent Class A voting units in each held by PMG to avoid the large discounts that a willing buyer would seek. Mitchell concluded that a hypothetical seller would pay PMG a premium for its 0.2 percent Class A voting units in Rabbit and Angus. Mitchell valued the Rabbit Class B nonvoting units at $8,918,940 (a 1.4 percent discount) and the Angus Class B nonvoting units at $31,456,742 (a 1.4 percent discount).

The court rejected Mitchell’s approach. Citing Estate of Giustina v. Commissioner, 586 F. App’x 417 (9th Cir. 417), rev’g and remanding T.C. Memo 2011-14, the court stated that the value at the date of the gift shall be the amount of the gift. The court would “not engage in imaginary scenarios as to who a purchaser might be.” The court then cited the statement in Olson v. United States, 292 U.S. 246 (1934), that

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

The court noted that the daughter, Margaret, the sole owner of the Class A voting units, testified that she had no intention of selling the units, and that if she ever sold the units, she would demand a premium higher than Mitchell’s estimated value.

The court found that that the facts did not show the reasonable probability of a willing seller or a willing buyer of the Class B nonvoting units also buying the Class A voting units or that the Class A units would be available for purchase. Instead, the examination should be limited to only the willing buyer and the willing seller of the Class B nonvoting units.

In rejecting Mitchell’s valuations of the Class B nonvoting units, the court stated that Mitchell’s reports lacked the empirical data to back up his calculation of the 5 percent premium to purchase the Class A voting units, evidence to show that his methodology was subject to peer review, and citations to case authority in support of his methodology.

The court then accepted Frazier’s valuation, noting that Frazier had combined the market approach and the income approach in valuing the Class B nonvoting interests.

One interesting fact is that any increase in the value of the Rabbit Class B nonvoting interests would have produced no additional gift or gift tax since that GRAT was a zero-out GRAT. Instead, the amount of the two annuity payments would have increased because of the adjustment clause in GRAT instrument adjusting the annuity if the value of the assets was adjusted.

* 1. **Estate of Mary P. Bolles v. Commissioner, T.C. Memo 2020-71**

**Advances made by decedent to son lost characterization as loans and became gifts of inheritance advances when decedent realized loans would not be repaid**

Mary Bolles died on November 19, 2010. While Mary was alive, she made large advances to her son, Peter, for more than twenty years to support him in his architectural business Upon Mary’s death, the Internal Revenue Service took alternative positions in auditing the estate tax return. The first was that a promissory note of $1,063,333 issued by Peter in favor of Mary plus interest of $1,165,778 should have been included as an asset of the estate. Alternatively, the IRS argued that Mary made adjustable taxable gifts to Peter of $1,063,333 that should be included in computing the estate tax liability. In the litigation, the IRS conceded its first position leaving whether Mary’s advances to Peter were gifts or loans as the only issue.

The court looked at Miller v. Commissioner, T.C. Memo 1996-3, aff’d 113 F.3d 1241 (9th Cir. 1997) for the traditional factors used to decide whether an advance is a loan or a gift. These factors include:

1. the existence of a promissory note or other evidence of indebtedness;

2. the charging of interest;

3. the use of security or collateral;

4. the present of a fixed maturity date;

5. the making of a demand for repayment;

6. any actual repayment;

7. the ability of the transferee to repay;

8. any records maintained by either the transferor or the transferee that reflect the transaction as a loan; and

9. the manner in which the transaction was reported for tax purposes.

The court also noted that in the case of a family loan, a long-standing principle is that an actual expectation of repayment and an intent to enforce the debt are critical to sustaining the characterization as a loan.

The court then noted that there were no loan agreements or attempts to enforce repayment even though Mary recorded the advancements as loans to Peter and kept track of the interest. The court also noted that Mary initially expected Peter to make a success of his architecture practice as his father (a successful architect) had. Mary lost that expectation slowly.

In reviewing the facts, the court then found that Peter was unlikely to repay any loans by October 27, 1989 when Mary amended her trust to block Peter from receiving any assets when she died. The block was lifted in 1995, when her trust was amended to treat the loans to Peter as advancements against his share. Accordingly, the loans lost that characterization for tax purposes in 1989. Consequently, the advances to Peter were loans through 1989 and after that were gifts. The court considered whether Mary had forgiven any of the prior loans in 1989 and found that Mary did not forgive the loans. Instead she accepted that the loans could not be repaid because of Peter’s financial distress at that time.

* 1. **Burt Kroner v. Commissioner, T.C. Memo 2020-73**

**Transfers from business associate were not gifts excludable from income under Code Section 102**

During the tax years 2005, 2006, and 2007, Burt Kroner received wire transfers from a business associate, David Haring, who was a foreign citizen, or entities associated with Haring, totaling $4,425,000, $15,350,000, and $5,000,000, respectively. Kroner’s lawyer, who was also Haring’s lawyer, advised that the transfers were excludable from income under Section 102 which states that gross income does not include the value of property acquired by gift, bequest, devise or inheritance. The lawyer also advised Kroner of the requirement to file the Form 3520, Annual Return to Report Transaction with Foreign Trusts and Receipt of Certain Foreign Gifts, for each year that Kroner received a transfer from Haring into an account in his name. The Internal Revenue Service argued that the transfers were not gifts and subject to income tax under Section 102(a) and imposed a penalty for substantial understatement under Section 6662(a).

The Tax Court, noting that the intention with which Haring made the transfers was the most critical factor in determining whether the transfers were gifts, found Kroner’s gifts story unconvincing and the testimony provided by Kroner and his lawyer to be unreliable. None of the testimony was supported by credible documented evidence. The lawyer represented both Kroner and Haring and was thus an interested party, and Haring, a foreign citizen, did not testify. As a result, Kroner was unable to prove that the transfers were made with disinterested generosity which is the basic requirement for a transfer to be treated as a gift. The court also noted the lawyer was evasive in his answer and in his selective invocation of the attorney-client privilege with respect to the legal advice provided to Haring about the transfers. Instead, the timing of the transfers, especially with respect to liquidity events in investments in which Kroner could not invest because of non-compete agreement, showed that Haring acted as the nominee for Kroner in those investments. The court could not find facts that showed that Haring and Kroner had the type of relationship from which there would be disinterested generosity and that would result in the substantial “gifts” which were made. Instead, Kroner and Haring had only a business relationship. As a result, the transfers were subject to income tax.

The court did not uphold the imposition of accuracy-related penalties for substantial understatement pursuant to Section 6662(a). The court found that the IRS failed to comply with the written supervisory approval requirement of Section 6751(b) when the Letter 915 which was the first letter to Kroner proposing accuracy-related penalties and providing an opportunity to file a protest with the Appeals Office was issued before the Civil Penalty Approval form was signed.

* 1. **Letter Ruling 202116001 (Issued July 9, 2020; Released April 23, 2021)**

**IRS rules on gift tax consequences of splitting QTIP Trust and then distributing one resulting trust to children**

Decedent died survived by spouse and two daughters. A marital trust, designated as the “Qualified Trust,” was created at decedent’s death. The Qualified Trust was a QTIP Marital Deduction Trust. Subsequently, the trustee divided the Qualified Trust into two trusts, Qualified Trust-A and Continuing Qualified Trust. The terms and provisions of each of the new trusts were identical to the terms in the original trust. Qualified Trust-A was funded with a specific amount of cash and marketable securities. All other assets were held in the Continuing Qualified Trust.

Subsequently, the trustees, the spouse, and the two daughters petitioned a state court to change the provisions of Qualified Trust-A. Under the modification, Qualified Trust-A would terminate upon the death of the last surviving income beneficiary. However, at any time prior to the spouse’s death, Qualified Trust-A could be terminated as to a beneficiary’s interest and any part of the trust property representing that terminated beneficiary’s interests would be distributed to that beneficiary if the trustee considered such distribution to be in the best interests of the beneficiary. The modification of the trust eliminated the surviving spouse as a beneficiary of Qualified Trust-A.

The IRS ruled first that the division of the Qualified Trust into Qualified Trust-A and the Qualified Continuing Trust did not cause the assets remaining in the Continuing Qualified Trust to be subject to gift tax under either Section 2512 or 2511.

However, the modification of the terms of Qualified Trust-A to change the beneficial interest to the spouse and the two daughters permitted the termination of spouse’s income interest. As a result, the spouse was deemed to have made a transfer of all the property of the Qualified Trust-A, other than the value of her qualifying income interest under Section 2519, and the spouse was deemed to have made a transfer of her qualifying interest in Qualified Trust-A under Section 2511. The transfers occurred when the court entered the order by which the income interest of the spouse in Qualified Trust-A was terminated and distributions from Qualified Trust-A were permitted to be made prior to the death of the spouse. Section 2519 provides that any disposition of all or part of a qualifying income interest for wife is subject to gift tax other than the qualifying income interest. Section 2511 would then apply to the gift of the qualifying income interest.

**ESTATE INCLUSION**

* 1. **Badgley v. United States, \_\_\_\_\_ F.3d \_\_\_\_\_ (9th Cir. 2020)**

**Assets of GRAT are included in settlor’s estate when settlor dies before end of annuity term**

The Ninth Circuit affirmed the district court’s granting of summary judgment to the Internal Revenue Service in a matter involving the inclusion of the assets of grantor retained annuity trust (“GRAT”) in the settlor’s estate when the settlor dies before the end of the annuity term. See Badgley v. United States, \_\_\_\_ F.Supp.3d \_\_\_\_\_ (N.D. Cal. 2018).

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

Patricia died on November 2, 2012 having received her last annuity payment from the GRAT on September 30, 2012, two months before the expiration of the annuity term. Her daughter, Judith Badgley was the executor of Patricia’s estate.

The federal estate tax return reported a gross estate of $36,829,057, including the value of the assets held in the GRAT. The estate paid federal estate taxes of $11,187,457. On May 16, 2016 the estate filed a claim of refund seeking $3,810,004 in estate tax overpaid by the estate as a result of the inclusion of the full value of the GRAT. The estate at the district court had moved for summary judgment on two bases, asserting that Section 2036(a)(1) did not apply to Patricia’s GRAT and that Treas. Reg. § 20.2036-1(c)(2) was overly broad and invalid to the extent that it applied to the GRAT and that the transfer of property to the GRAT was a bona fide sale for full and adequate consideration and Section 2036 did not apply to cause inclusion of the property in the GRAT in the estate. The government moved for summary judgment on the opposite grounds.

The Ninth Circuit started it opinion by noting that “thanks to Benjamin Franklin, death and taxes are inextricably linked in most American minds as the only two things in the world that are certain.” It then explained that Section 2036(a) was the response of Congress to the attempts of taxpayers to avoid the estate tax by using a variety of legal mechanisms to transfer property during their lifetimes while holding onto the fruits of that property. The presence of one or more of three strings -- possession, enjoyment, or the right to income – would cause estate inclusion. The issue for the Ninth Circuit was whether Patricia’s annuity interest in the GRAT was a sufficient string to cause the inclusion of the GRAT in Patricia’s estate.

The Ninth Circuit first addressed the estate’s argument that because Section 2036(a)(1) does not contain the term “annuity,” that section does not unambiguously apply to annuities. The Ninth Circuit disagreed. Congress instead instructed courts to look at the results – possession, enjoyment, or the right to income – rather than the form those strings took. Citing Commissioner v. Church’s Estate, 335 U.S. 632 (1939), the Ninth Circuit rejected the estate’s argument that because Section 2036(a)(1) does not mention annuities, the full value of Patricia’s annuity could not be included in Patricia’s estate.

The Ninth Circuit then moved to main issue of whether the annuity flowing from a GRAT fell within the class of will substitutes to which Section 2036(a)(1) applies. The estate argued that a “fixed-term annuity” was not the same as a right to income or some other form of possession or enjoyment as required by Section 2036(a)(1). The Ninth Circuit concluded that deriving a substantial economic benefit from property is sufficient for the application of Section 2036(a)(1). In turn, Patricia’s annuity from the GRAT was a substantial economic benefit.

The Ninth Circuit that rejected the estate’s attempt to say that the Supreme Court disavowed a “substance over form” argument in United States v. Byrum, 408 U.S. (1972), by noting that Byrum stated that enjoyment connoted a substantial economic benefit. Moreover, its interpretation of Section 2036(a)(1) was within the meaning of the text of that section. The Ninth Circuit then quotes various commentators with respect to the manner in which GRATs work including John Bergner that “there is no solution to the problem of dying earlier than expected,” 44 U. Miami L. Ctr. On Est Plan. ¶ 401.1 (2019) and Howard Zaritsky that the grantor of a GRAT makes the decision that the potential benefits outweigh the risks. *Tax Planning for Family Wealth Transfers During Life: Analysis with Forms,* ¶ 12.06(1) (5th ed. 2013 & Supp. 2020).

Badgley also challenged Treas. Reg. 20.2036-1(c)(2) which requires that transferred GRAT property be included in a decedent’s gross estate where the decedent retains an annuity interest and dies before the expiration of the annuity term and provides the formula for the calculation of the property includable under Section 2036(a). The Ninth Circuit noted that the argument on this issue was limited to two sentences and two footnotes. The cursory manner in which the argument was made waived the argument under the Federal Rules of Appellate Procedure 28(a)(8)(A). Even if the argument was not waive, it would not apply. Instead of showing how the formula was flawed or contesting the application of the formula to the annuity, Badgley merely contended that formula might be arbitrary if it was applied to a short-term GRAT which was not the case here.

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

* 1. **Estate of Clara M. Morrissette v. Commissioner, T.C. Memo 2021-60**

**Tax Court rejects estate’s valuation of decedent’s contract rights in six split-dollar life insurance arrangements and imposes penalty for gross undervaluation**

This decision is the latest installment in the litigation over the estate of Clara Morrissette who died in 2009. In Morrissette, the Internal Revenue Service issued a notice of deficiency with respect to the fair market values of the decedent’s contract rights in six split-dollar life insurance arrangements which the IRS increased from the $7,479,000 value reported on the estate tax return to $32,060,070, which was the cash surrender value of the underlying life insurance policies. The estate at trial argued that the contract rights had a fair market value of $10,452,000.

The court considered the following issues:

1. Whether Section 2036 or Section 2038 applied to recapture inter vivos transfers as part of the split-dollar agreements?

2. If Sections 2036 and 2038 did not apply, would Section 2703 apply to require that the valuation disregard a provision in the split-dollar agreements that restricted the parties’ rights to unilaterally terminate the agreements (the “mutual termination” restriction”) and cause the inclusion of the of the cash surrender values of the six life insurance policies in the gross estate?

3. If Section 2703 did not apply, what was the fair market value of the estate’s interests with respect to the split-interest agreements?

4. Was the estate liable for either the 40 percent penalty for gross undervaluation of the estate’s interests with respect to split-interest agreements or the 20 percent penalty for substantial undervaluation of the estate’s interests with respect to the split-dollar agreements?

Arthur and Clara Morrissette, who were the owners of Interstate Group Holdings (which was in the moving, relocation, and storage business) and their three sons, Buddy, Ken and Don, engaged in sophisticated estate planning to ensure that Interstate remained in the family after each of Arthur’s and Clara’s deaths and that it would eventually pass to their children and then to their grandchildren. The planning sought to minimize and avoid the disruptions previously caused by the contentious relationships between each of the children and their father as well as contentious relationships among themselves with respect to Interstate in which each worked. For example, Don and Ken both left the business after disagreements with their father and the other brothers. After Arthur Morrissette’s death in 1996, Clara, who then had direct or indirect control of Interstate, worried that the disagreements among her sons would lead to lawsuits, but she wanted Interstate to remain a family business and for the brothers to work out their differences.

By 2005, Clara Morrissette was diagnosed with Alzheimer’s disease and dementia. In early 2006, one grandson met with an insurance broker at a fundraising dinner for his alma mater. This led to the insurance broker and a lawyer who often worked with him, to meet with the family and to propose estate planning strategies to the family. The insurance agent and the lawyer explained to the family that the estate tax owed on Mrs. Morrissette’s death was unlikely to qualify for a Section 6166 deferral (because of substantial passive real estate holdings that Mrs. Morrissette held) as the family had previously thought. Consequently, a large amount of estate tax would be due nine months after Mrs. Morrissette’s death. To avoid this and to help insure continued family ownership of Interstate, the insurance agent and the lawyer proposed the purchase of life insurance on each brother’s life, the proceeds of which could be used to buy out the interests in Interstate in a departed brother pursuant to a shareholders agreement. The family then implemented the business succession plan.

On August 18, 2006, a Virginia county court declared Mrs. Morrissette permanently incapacitated and appointed a temporary limited conservator to help implement the 2006 business succession plan.

On September 15, 2006, Clara Morrissette’s revocable trust established perpetual dynasty trusts for the benefit of each son. Each son was co-trustee of his trust with Interstate’s chief financial officer (whose only function was to sign documents). Each trust authorized the purchase of life insurance on the lives of the other brothers.

On September 19, 2006, Clara Morrissette’s revocable trust was amended to permit the revocable trust to enter into split-dollar arrangements and similar arrangements to assist Interstate’s shareholders with funding their obligations under Interstate’s business succession plan.

On September 21, 2006, the various trusts set up by Arthur Morrissette at his death for the benefit of Clara, Clara Morrissette’s revocable trust, the brothers, and the dynasty trusts executed a shareholders agreement which included buy-sell arrangements upon the death of each brother. The shareholder’s agreement obligated the surviving brothers to use “best efforts” to negotiate for the purchase of a deceased brother’s stock and required shareholders to provide a right of first offer for their shares. The brothers believed that the agreement furthered their parents’ intent for Interstate to remain a viable family-owned business.

On October 4, 2006, each brother’s dynasty trust purchased two flexible-premium life insurance policies. The policies insuring Don’s life were purchased from American General and the policies insuring Buddy’s and Ken’s lives were from MassMutual.

In October 2006, the three brothers in their capacity as agents under Mrs. Morrissette’s power of attorney, co-trustees under Mrs. Morrisette’s revocable trust, and co-trustees of their respective dynasty trusts entered into two split-dollar arrangements with each dynasty trust to allow the payment of the full premium on each of the six policies. The full premium for each of the two American General policies was $4.97 million and the full premium for each of the four Mass Mutual policies was $4.99 million. The insurance agent earned $1 million in commission on the purchase of the policies.

Under the split-dollar agreements, Clara Morrissette’s revocable trust was entitled to receive the greater of the amount of the premiums it paid or the cash surrender value of the life insurance policy upon either the death of each brother or the termination of the split-dollar agreement during the life of the insured. This was the revocable trust’s sole right under each split-dollar agreement.

The parties to the split-dollar agreements could terminate each arrangement only by mutual assent. Mrs. Morrissette’s revocable trust was specifically prohibited from canceling or surrendering the policies.

Mrs. Morrissette reported the payment of the premiums as gifts to her sons for gift tax purposes to the extent required by the economic benefit regime, which treats the payment of premiums as annual gifts equal to the annual cost of the current protection. From 2006 to 2008, the total cost of the current protection (the economic benefit) was $1,443,526. Also during that period, the dynasty trusts paid premiums to reduce the amount of the taxable gifts from Mrs. Morrissette.

After the death of Clara Morrisette in 2009, the IRS challenged the gift tax treatment of the split-dollar agreements arguing that the split-dollar arrangements did not qualify for the economic benefit regime and that Mrs. Morrissette made $29.9 million in gifts in 2006 when the revocable trust paid the full premiums through the split-dollar arrangements. In Estate of Morrissette v. Commissioner, 146 T.C. 171 (2016), the Tax Court held that the split-dollar agreements complied with the economic benefit regime and Mrs. Morrissette did not make taxable gifts of the premium in 2006 and made annual gifts only of the costs of current protection for gift tax purposes. Mrs. Morrissette’s revocable trust was the deemed owner for gift tax purposes.

After the 2006 transactions, the three brothers faced health situations. Buddy was diagnosed with brain cancer which took his life in 2016. In 2009, Ken and Don agreed to a partial buyback of Buddy’s non-voting shares. In April 2009, Ken was diagnosed with terminal cancer but outlived the life expectancy his doctor predicted.

On the federal estate tax return, the estate reported a fair market value of $7,479,000 for Clara Morrissette’s split-dollar rights using the alternate valuation date. Craig Stephanson prepared the appraisal attached to the estate tax return. The estate conceded on audit that Stephanson incorrectly deducted gift tax of $2.97 million in his computation of the fair market value on the assumption that the gift tax would transfer over to the split-dollar agreements. The estate now asserted that Stephanson’s analysis resulted in a fair market value of $10,449,000. The estate also used Shishir Khetan as an expert. Khetan valued the split-dollar rights of the estate at $7,808,314.

The IRS’ appraiser, Francis Burns, opined that in the absence of the mutual termination restriction, the split-dollar rights of the estate would have a fair market value equal to the cash surrender value. With the mutual termination restriction, the estate’s split-dollar rights had a fair market value of $17,501,391 assuming the split-dollar agreements remained in effect until the brothers’ deaths or $27,857,079 assuming they terminated on December 31, 2013 (which was three years after the filing of the estate tax return and the end of the period in which the estate tax return could be audited and which the lawyer had advised the brothers was the earliest date on which the split dollar arrangements should be terminated).

Each of the three experts used the discounted cash flow method of valuation. They calculated an expected value of each policy for each year of the insured’s life expectancy by determining the policy’s expected cash surrender value for each year multiplied by the probability of the insured’s death that year. They then discounted the probability adjusted expected value to a present value. The estate’s appraisers used a discount rate of 15 percent. The IRS thought that the discount rate should be much lower. The IRS’s appraiser determined that the discount rates should be 9.35 percent for the American General policies and 6.9 percent for the MassMutual policies (after adjustment for a lack of liquidity premium).

The court first held that neither Section 2036 nor Section 2038 applied to the transfer of premiums that Clara Morrissette’s Trust made as part of the split-dollar arrangements. If either had applied, the amount of the transferred premiums, $30 million, or the cash surrender values of the underlying policies, approximately $32.6 million, would have been included in Mrs. Morrissette’s estate.

The court determined that the exception to Sections 2036 and 2038 for a bona fide sale for adequate and full consideration money or money’s worth applied. It first found that Clara Morrissette’s desire to keep Interstate in her family was a legitimate non-tax reason for the transfer and therefore the transfer met the test for a bona fide transaction. The court then noted that on the basis of the record, unrelated parties would have agreed to similar terms.

With respect to the adequacy of the consideration, the court first rejected the estate’s argument that the estate tax consequences of the split-dollar agreement should be consistent with the economic benefit regime. The court noted that compliance with the economic benefit regime does not mean that adequate and full consideration has been paid and that the economic benefit regime does not apply for estate tax purposes. The court stated that the bona fide sale exception does not require an arm’s-length transaction and an intra-family transfer can constitute a bona fide sale. The split-dollar agreement was part of the 2006 plan that provided incentives for the brothers to remain in Interstate and protected against foreseeable risk to Interstate’s business.

The court agreed with the IRS’ assertion that adequate and full consideration should be defined based on fair market value. It also noted that the adequacy of consideration is measured on the transfer date and not on the date of the decedent’s death. It found that Clara Morrissette’s revocable trust received adequate and full consideration on the basis of the repayment terms that included interest earned in the form of inside build-up of the insurance policies. The split-dollar agreements also provided the additional benefit of tax deferral on the inside build-up and the tax exempt payout of the death benefits to the beneficiaries. The issue here was not the execution of split-dollar agreements, but rather the undervaluation of the split-dollar rights on the estate tax return.

The court next found that the Section 2703(b) exception applied to exempt the transaction from the imposition of the special valuation rules of Section 2703 and to allow the mutual termination assent provision of the shareholders agreement to be taken into account in valuing the estate’s rights in the split-dollar arrangements. To qualify for the exception, the estate had to show:

1. The restriction is a bona fide business arrangement.

2. The restriction is not a device to transfer property to members of the decedent’s family for less than full and adequate consideration; and

3. The restriction is comparable to the terms of similar arrangements in arm’s-length transactions.

The court found that the agreement was a bona fide business arrangement because it was part of planning for the future liquidity needs of Clara Morrissette’s estate. In addition, the mutual termination restriction furthered the business purposes of the split dollar arrangements and had a significant effect in supporting those business purposes.

The court next noted that the mutual termination restriction, which it felt must be viewed as the testamentary device as opposed to the entire split-dollar arrangement, was not a device to transfer funds at less than full and adequate consideration. Clara Morrissette’s revocable trust did not enter into the split-dollar agreements as an attempt to evade estate tax. As a result, the mutual termination restriction would not be considered a testamentary device. The court then held that the split-dollar agreements were entered into at arm’s length, especially in light of the brothers’ acrimonious relationships and disputes over Interstate’s ownership. The court therefore believed that a split-dollar agreement entered into by a closely-held business may contain a mutual termination restriction and would be similar to arms-length transaction. Since the requirements for the Section 2703(b) exception were met, Section 2703(a) would not apply.

The resolution of the case required a determination of the fair market values of split-dollar rights. The court accepted the IRS’ expert’s discount rates of 8.85 percent for the two American General policies and 6.4 percent for the four Mass Mutual policies. While the court would have determined the liquidity premium for the lack of marketability differently, it accepted the lack of liquidity premium determined by the IRS’s expert. The court also rejected the use of life settlement yields as the discount rate because the differences between life settlements and split-dollar arrangements make the comparisons unreliable.

The court was not convinced that there was no prearranged plan to terminate the split-dollar arrangements when the agreements were entered into as the estate argued. Since the dynasty trusts had full control over the policies financed by the split-dollar arrangements, applying a maturity date of December 31, 2013 was appropriate.

The court then directed the parties to determine the annual probability-adjusted expected value for each policy on the basis of Mr. Stephanson’s expected cash surrender values and Mr. Burns’ probabilities of mortality to the extent such values and probabilities were more favorable to the estate than those used by Mr. Burns It also directed the parties to apply discount rates of 8.85 percent and 6.4 percent for the American General and Mass Mutual policies respectively to the annual probability adjusted expected values to determine the fair market values and to assume a maturity date of December 31, 2013.

The court also imposed an accuracy-related penalty for a gross understatement of 40 percent under Section 6662(a). It found that the estate had not acted with reasonable cause and in good faith. The court noted that the estate’s appraiser opined that the value of $7.5 million was unreasonable and that the brothers should amend that value upwards. The brothers were also aware that the insurance agent and the lawyer marketed the arrangements as estate tax savings strategy. Knowing that any estate tax savings would be from the undervaluation of split-dollar rights, the brothers engaged an appraiser that the lawyer recommended. The lawyer reviewed a draft of the Mr. Stephanson’s appraisal and asked Mr. Stephanson to reduce his original values which Mr. Stephanson did. As a result, Mr. Stephanson’s appraisal was not reasonable and petitioners did not rely on it in good faith.

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

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

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

Richard was the settlor of a revocable trust called the Survivor Trust. Patrick was the trustee of the Survivor Trust and was also decedent’s attorney-in-fact under a California Power of Attorney. Richard’s involvement in the three split dollar life insurance arrangements was effected solely through the Survivor Trust and was directed by Patrick Cahill either as decedent’s attorney in fact or as trustee of Survivor Trust. The parties agreed that everything in the Survivor Trust on decedent’s date of death was included in the decedent’s gross estate. Decedent was also settlor of the Morrison Brown (“MB”) Trust which was created in September 2010 by Patrick Cahill as decedent’s agent. William Cahill was trustee of the MB Trust and the primary beneficiaries of the MB Trust were Patrick and his issue. The MB Trust owned three whole life insurance policies. Two policies were on the life of Shannon Cahill, Patrick Cahill’s wife, and one policy was on the life of Patrick Cahill. The policy premiums were paid in lump sums as shown in the chart below.

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

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

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

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

The court also reviewed the argument of the government that Section 2703 would apply to the MB Trust’s ability to veto termination of split-dollar arrangements. It found that split dollar agreements, taken as a whole, clearly restricted decedent’s right to terminate the agreements and withdraw his investment from those arrangements. The court stated that the requirements of Sections 2703 were met and therefore denied the motion for summary judgment with respect to this. The court also noted that the parties had not addressed the exception in Section 2703(d) which provides for comparison with the terms of any similar arrangements entered into by persons in arms’ length transactions.

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

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

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

* 1. **Estate of Frank D. Streightoff v. Commissioner, \_\_\_ F.3d \_\_\_ (5th Cir. 2020)**

**Fifth Circuit upholds decision of Tax Court imposing additional estate tax liability for limited partnership interest included in estate**

This was an appeal to the Fifth Circuit in which the Fifth Circuit upheld the decision of the Tax Court in favor of the government. See Estate of Frank D. Streightoff v. Commissioner, T.C. Memo 2018 – 178.

On October 1, 2008, Frank D. Streightoff created a revocable living trust of which his daughter, Elizabeth Streightoff was the trustee. In addition, on October 1, 2008, Streightoff Investments, LP (“SILP”) was created as a Texas limited liability partnership. Frank held an 88.99 percent limited partnership interest in SILP. Each of his daughters had a 1.54 percent limited partnership interest. His Sons and former daughter-in-law each held a .77 percent limited partnership interest.

The sole general partner of SILP was Streightoff Management which held a one percent ownership interest. Elizabeth was the managing member of Streightoff Management.

Finally, on October 1, 2008, Frank assigned his 88.99 percent interest in SILP to his revocable trust. The assignment of Frank’s interest to the revocable trust was executed by Elizabeth as Frank’s agent under his durable power of attorney. Elizabeth also signed the approval of the transfer as Streightoff Management’s managing member (the general partner of SILP) and for the assignee as the trustee of the revocable trust.

Frank Streightoff subsequently died on May 6, 2011. Frank’s estate (of which Elizabeth was executor) reported a taxable estate of $4,801,662 on its federal estate tax return. The estate listed the 88.99 percent interest in SILP as an assignee interest with a value of $4,588,000 as of the alternate valuation date. This valuation reflected discounts for lack of marketability, lack of control, and lack of liquidity.

Subsequently, the IRS issued a notice of deficiency of $491,750. The IRS increased the value of the estate’s 88.99 percent interest in SILP to $5,993,000 as compared to the estate’s valuation of $4,588,000. This represented an increase in value of $1,405,000 or approximately 31 percent. The IRS stated the value of Frank’s interest in SILP could only be discounted for lack of marketability and not for lack of control and lack of liquidity.

In the proceedings before the Tax Court, the Tax Court rejected the estate’s claim that the IRS’s notice was subject to the provisions of the Administrative Procedures Act (“APA”) on a motion for summary judgment. The Tax Court held that the APA did not apply to proceedings related to a redetermination of a deficiency. The Tax Court concluded that the Notice of Deficiency complied with the requirements of Section 7522(a) of the Internal Revenue Code.

At trial, the valuation experts for the estate and for the IRS were the only witnesses. The Tax Court determined that the revocable trust held a limited partnership interest in SILP at the alternate valuation date because the Assignment validly assigned the SILP interest as a limited partnership interest both in substance and form. As a result, the revocable trust held a limited partnership interest in SILP and not an assignee interest. See Estate of Frank D. Streightoff v. IRS, T.C. Memo 2018-178.

On appeal, Streightoff’ s estate challenged the decision of the Tax Court on two grounds. First, the estate contended that in using a substance over form rationale to conclude that the estate held a limited partnership interest, the Tax Court’s opinion was contrary to Texas partnership law. It also violated a doctrine set forth in Sec. & Exch. Comm’n v. Chenery Corp., 382 U.S. 194 (1947). Second, the estate asserted that the notice issued by the IRS failed to comply with both Section 7522(a) and the APA.

The court first noted that because the partnership agreement had specific provisions on the issue of the nature of the interest transferred, it was unnecessary to consult Texas law. It noted that Texas law provides that a court should look to the Texas Uniform Partnership Act for guidance only when the partnership agreement is silent. It also noted that the assignment was a” Permitted Transfer” under the provisions of Section 9.2, which permitted limited partners to transfer their interest to a member of the limited partner’s family. Here, the decedent was the transferor under the assignment and basically and effectively assigned the interest to himself as a member of his family when he assigned the interest to the revocable trust.

Section 9.7 of the SILP Partnership Agreement provided the requirements for attaining legal status as either a transferee or assignee. To be admitted as a substituted limited partner, Section 9.7(b) required that the transferee receive its interest through a “Permitted Transfer” under Section 9.2. This provision was obviously satisfied.

The estate and the IRS diverged on the application Section 9.7(a), which required that the transferee obtain consent from the general partner of SILP. The Fifth Circuit found that Streightoff Management’s managing partner, Elizabeth, had the unilateral decision-making authority to admit the assignment interest as a substituted limited partner. The estate argued that the requirements of Section 9.7(a) were not met because of an absence of the consent of Streightoff Management to admit the revocable trust as a substituted limited partner. The IRS believed that the broad language of the assignment transferred the decedent’s full partnership rights to the revocable trust. When Elizabeth, as trustee of the revocable trust signed and, as manager of Streightoff Management, approved the assignment, she consented to the transfer of the decedent’s 88.99 percent interest as a substituted limited partner interest.

The Fifth Circuit agreed with the IRS. It noted that the unambiguous language of the assignment purported to convey more than an assignee interest. The assignment stated that the decedent assigned “all and singular the rights and appurtenances thereunto in anywise belonging.” This was more than a transfer of an assignee interest. In addition, Elizabeth signed the assignment under the legend “approved by.”

The Fifth Circuit, from an economic reality standpoint, also agreed with the Tax Court’s alternative substance over form rationale. The Tax Court stated, “regardless of whether an assignee or a limited partnership interest had been transferred, there would have been no substantial difference before and after the transfer to the revocable trust.” The substance over form doctrine permits a court to determine if a transaction is characterized according to the underlying substance of the transaction rather than its legal form. The Fifth Circuit noted that the assignment lacked any economic substance outside of tax avoidance. It noted that there were no practical differences before and after the assignment was executed with respect to what managerial and oversight powers limited partners enjoyed that unadmitted assignees did not. Without any genuine nontax circumstances present, the assignment was the functional equivalent of a transfer of a limited partnership interest under Kerr v. Commissioner, 113 T.C. 449 (1999).

The Fifth Circuit also rejected the Chenery argument. There, a reviewing court in dealing with a determination or judgment, which an administrative agency alone is authorized to make, must judge the propriety of such action solely by the grounds invoked by the agency. That type of decision was not involved here because the Tax Court was determining the notice of tax deficiency de novo and not critiquing the determination of the IRS.

The Fifth Circuit also summarily dealt with the estate’s arguments that the notice of deficiency failed to comply under the APA. The APA’s judicial review proceedings were not intended to supplant existing statutory schemes that set forth clear pre-existing procedures for review such as the deficiency statute at review in this case.

The Fifth Circuit then affirmed the decision of the Tax Court.

* 1. **Estate of Moore v. Commissioner, T.C. Memo 2020-40**

**Tax Court holds that assets in family limited partnership should be taxed in decedent’s estate at their full fair market value**

This case is an example of quite aggressive estate planning which leads to bad facts making bad law. The facts in Moore are some of the most extreme that have ever underlain a case involving the availability of discounts for interests held in family limited partnerships and limited liability companies at a decedent’s death.

Howard Moore was born in poverty and had a difficult upbringing. His formal education ended in the eighth grade. Through hard work Moore was able to acquire more than a thousand acres in the Dome Valley near Yuma, Arizona and build a thriving farm. Moore was quite rough on his four children and often played his three Sons against each other to motivate them. He also had one daughter. Moore also suffered from a long battle of alcoholism before going to a rehab facility for help.

Moore began to think about selling the farm and in 2004, when he was 89, Moore became more focused on selling the farm. Before Moore could complete a sale to a neighbor, Mellon Farms, he had congestive heart failure, a heart attack, heat stroke, and was unable to breathe on his own. He insisted on returning home and was put on hospice care because he was given less than six months to live. Moore continued to work and a priority was to put his affairs in order.

At the end of December 2004, Moore called Bradley Hahn, an estate planning attorney with fifteen years of specialization in estate planning. Hahn had previously worked on Mrs. Moore’s estate plan.

Moore’s description of his estate planning goals focused primarily on maintaining control and eliminating estate tax. Other goals included the maintenance of his customary lifestyle, providing adequate liquidity for emergencies and investment opportunities, sufficient cash flow to make annual gifts to his children, the equal treatment of his children (although his son, Virgil, was to get his residence, his son, Ronnie was to get ½ of his interest in RRCH Moore Custom Farming and all of his interest in Yuma Speedway, LLC, and his grandson, Chet, was to get ½ of his interest in RRCH Moore Custom Farming), creditor protection, and the reduction of income,and estate taxes.

In order to accomplish his goals, Moore, with Hahn’s help, four days after being discharged from the hospital, on December 20, 2004 created the following trusts:

1. Howard V. Moore Living Trust
2. Howard V. Moore Charitable Lead Annuity Trust
3. Howard V. Moore Children’s Trust
4. Howard V. Moore Family Management Trust
5. Howard V. Moore Irrevocable Trust

Moore also created the Howard V. Moore Family Living Partnership.

Moore was trustee of the Living Trust with his Son, Virgil, and his daughter, Lynda. Moore transferred all of his real and intangible personal property to the Living Trust, including his farm, which went under the name “Moore Farms.” Upon his death, the remaining trust property was divided between the charitable lead annuity trust (referred to in the opinion as the “Charitable Trust”) and the Children’s Trust.

The Charitable Trust was to make distributions to the Howard V. Moore Foundation, which would then contribute money to the Community Foundation for Southern Arizona where the distribution would be distributed among several charities as determined by the boards of the Moore Foundation and the Community Foundation. The purpose of the Charitable Trust was to provide a vehicle through which the four children could remain on speaking terms.

The amount to be distributed by the Living Trust to the Charitable Trust was defined as a fraction of the full estate that would result in the least possible federal estate tax being paid as a result of Moore’s death taking into account the applicable exclusion amounts. The Charitable Trust at the time of the trial, had donated a total of $2.5 million to the Community Foundation. However, Hahn testified that the purpose of the trust was to provide a vehicle through which Moore’s children would keep on speaking terms.

The remainder of the Living Trust property was to be distributed at Moore’s death to the Children’s Trust which, in turn, provided for the distribution of the remaining trust property to each of the four children in equal shares. The Children’s Trust also contained the gifts of the specific assets that Moore intended to make, including the gift of the residence to Virgil and the gift of Moore’s ½ interest in RCCH Moore Custom Farming and Moore’s 100 percent interest in Yuma Speedway, LLC.

The only purpose of the Management Trust was to be a partner in the Family Limited Partnership. Its only asset was a one percent interest in the Family Limited Partnership. The initial trustees were Virgil and Lynda and its designated beneficiary was Moore. Upon Moore’s death, the remaining assets in the Management Trust were to be transferred to each of the four children through the Living Trust.

The Irrevocable Trust was initially funded with $10 with Virgil as its trustee and Moore’s children as the beneficiaries. Subsequently, interests in the Family Limited Partnership were sold to it. The Irrevocable Trust provided for discretionary distribution of income and principal to the children. It also contained a provision for the transfer to the Living Trust of the amount of any asset included in Moore’s estate. Following Moore’s death, the Irrevocable Trust transferred large sums to the Charitable Trust. For example, from 2007 to 2009, the Charitable Trust made three payments to the Foundation of $790,000, $433,818, and $433,818 respectively.

In addition to the five trusts, Moore also set up the Family Limited Partnership on December 20, 2004. The Tax Court referred to the Family Limited Partnership as the “keystone” of Moore’s estate plan. The Management Trust, the Living Trust, and the four children each made a total initial contribution of $10,000. These transfers gave each contributor a one percent interest. In addition, one Son, Ronnie, contributed his partial interest in another farm, (called Doval Farm) to the Family Limited Partnership in what the court described as a roundabout way. First Ronnie and Moore deeded their separate interest in Doval Farm to the Living Trust. The Living Trust then contributed Doval Farms to the Family Limited Partnership along with 4/5ths of Moore’s farm. In return, the Living Trust received a 94 percent interest (and then had 95 percent of the interests in total).

During trial, Moore’s Son maintained that the purpose of the Family Limited Partnership was to protect against liabilities, creditors, and bad marriage and to help bring the family together. Under the family limited partnership agreement, no single partner could transfer or sell any interest without the unanimous consent of the remainder of the family. The limited partners had no right to participate in the business or management decisions. In Moore’s last months, he negotiated the sale of Moore Farms. Moore Farms was under contract with Mellon Farms for $16,512,000 within five days after Moore contributed Moore Farms to the Living Trust. The court noted that even though the Family Limited Partnership held 4/5ths of the interests in the Moore Farms, the decision to sell was made solely by Moore. Moore continued to live on the property after his death (which was not unusual in the Dome Valley when a long held family farm was sold).

After the creation and funding of the trusts and the Family Limited Partnership, Moore had other items to complete.

The first was the payment of attorneys’ fees to Hahn for the estate planning which totaled $320,000. Part of the payment came from the Family Limited Partnership shares and proceeds from the sale of the farm, and part came out of the Living Trust.

Moore also had the Family Limited Partnership issue a check for $500,000 to each of his four children. Moore required each child to sign a promissory note for the money, which was to be paid back on or before February 2020 at a stated rate of interest. None of Moore’s children made payments of principal and interest and the Family Limited Partnership made no effort to collect. Moore’s grandson, Chet, also received a $500,000 check which was actually a gift. The Family Limited Partnership then paid $2,000,000 to the Living Trust to be used to cover expenses of the land sale, various miscellaneous items, and income taxes owed on the sale of the farms.

Subsequently, Moore appears to have engaged in a sale to a defective grantor trust transaction. First, Moore’s Living Trust s transferred $500,000 to the Irrevocable Trust. This transfer was reported on Moore’s 2005 gift tax return as a gift of $125,000 to each of the four children. Two weeks later, the Living Trust transferred its entire interest in the Family Limited Partnership to the Irrevocable Trust for $500,000 in cash and a note for $4.8 million. Moore died shortly thereafter at the end of March 2005. After his death, the Living Trust covered many of his final expenses including a flat fee to Bradley Hahn of $475,000 for the administration of the estate (in addition to Hahn’s fees of $320,000 for designing the estate plan)..Moore’s 2005 gift tax return reported the $500,000 gift to Chet and the four separate $125,000 gifts to each of Moore’s children.

The Internal Revenue Service reviewed the estate tax return and determined an estate tax deficiency of $6.4 million. It also determined a gift tax liability of more than $1.3 million in 2005.

At trial, The Tax Court examined four issues.

1. Would the underlying value of the farm be taxed in Moore’s estate under Section 2036 despite its sale through the Family Limited Partnership?

2. If some value of the farm was included in the estate, did the subsequent transfer of the Living Trust’s Family Limited Partnership interest to the Irrevocable Trust remove that value?

3. Could Moore’s estate deduct a $2 million debt payable to the Family Limited Partnership, future charitable contribution deductions through the Charitable Trust, and $475,000 in attorney fees?

4. Whether Moore’s transfers of $500,000 to each of his children were gifts or loans?

In the Tax Court proceedings, the IRS viewed Moore’s estate plan as “nothing more than a last minute, last ditch effort to avoid paying tax.” It argued that Section 2036 should apply because the transfer of 4/5ths of the farm to the Family Limited Partnership was not a bona fide sale for full and adequate consideration since Moore lacked legitimate non-tax reasons for forming the Family Limited Partnership and because Moore kept possession and enjoyment of the farm even after its sale. Thus, Moore had a retained use and enjoyment of the property under Section 2036(a)(1). The IRS also argued that Moore’s retention of control over the Family Limited Partnership was a power to control the use and enjoyment of the property by others under Section 2036(a)(2). As a backup argument, the IRS argued that the subsequent sale of the Living Trust’s interests in the Family Limited Partnership to the Irrevocable Trust was not a bona fide sale for full and adequate consideration but a deemed gift. This should also cause the value of the underlying assets in the Family Limited Partnership to added back into the estate.

The IRS disputed the availability of the estate tax charitable deduction for amounts transferred to Charitable Trust because the amounts passing to charity could not be determined as of the date of Moore’s death and were contingent on the IRS’s examination of the estate tax return. The IRS argued against the deduction of the attorneys’ fees either because they were not incurred in the administration of the estate or they were unreasonably high.

Finally, the IRS argued that the $500,000 cash payments to the four children were gifts and not loans.

The court first looked at the applicability of Section 2036. Using the test in Estate of Bongard v. Commissioner, 124 T.C. 95 (2005), a transfer will not be respected if:

1. The decedent made an inter vivos transfer of property;

2. The decedent’s transfer was not a bona fide sale for adequate and full consideration; and

3. The decedent retained an interest of right in the transfer property.

The court noted that whether a transfer was for adequate and full consideration is a question of value. Whether a transfer of property was bona fide turns on motive. The court then noted that under Bongard, the sale is bona fide only if there is a legitimate and significant non-tax reason for creation of the Family Limited Partnership. Moore’s estate asserted that the principal reason for the formation of the Family Limited Partnership and transferring the interest in Moore Farms to the Family Limited Partnership was to bring the family together so they could learn how to manage the business without Moore. However, the court noted that after the sale of the farm, the only assets left in the Family Limited Partnership were liquid and an investment advisor managed them, not the family members. At trial, the Sons maintained the Family Limited Partnership also provided protection from creditors. The court said that protection from creditors can be considered a legitimate, but not significant, non-tax reason to form a family limited partnership. Moreover, no credible evidence had been introduced that any of the children had a legitimate concern with possible creditors’ claims. The court also found other factors supporting a finding that the transfer was not bona fide. One was Moore’s significant health problems and his desire to save millions of dollars of taxes. The second was his creation of a complex and extensive estate plan four days after being discharged from a hospital in critical condition and placed in the care of hospice. Finally, Moore’s unilateral decision making and control of the entire process contradicted any assertion of a bona fide sale.

The court then reviewed as an alternate holding, whether Moore retained possession or enjoyment of the transferred interest after the transfer. This would be based on retaining a substantial present economic benefit. The court found that Moore continued to live on the property and continued to operate the farms as his own up until the date of his death. Even after the sale of the farm, Moore used the now liquid assets of the Family Limited Partnership to pay his expenses even though he kept sufficient assets of his own. This pattern was evidence of an implied agreement to retain the use of the property. Essentially Moore’s relationship to the assets of the Family Limited Partnership remained unchanged before and after the transfer. Consequently, because Moore retained possession or enjoyment of the assets in the Family Limited Partnership and because his transfer of part of the ownership of the Family Limited Partnership lacked a substantial non-tax purpose, the value of Moore Farms was to be included in the value of the estate under Section 2036 (a)(1).

Because the court concluded that Section 2036(a)(1) applied, it did not address the 2036(a)(2) or deemed gift arguments advanced by the IRS

The court then discussed the impact of the full Tax Court decision in Estate of Powell v. Commissioner, 148 T.C. 392 (2017) which analyzed, for the first time, the application of Section 2043(a) of the Code as it applied to family limited partnerships. In Powell, the court held that where Section 2036 compelled inclusion of the assets in a family limited partnership at the fair market value, Section 2033 also compelled inclusion of the partnership interests in the estate at the discounted value. Before, it had always been an “either or” analysis. Now, one must look at Section 2043(a). Section 2043(a) allows the estate to subtract the value of the partnership interest that is included under Section 2033 from the full value of the partnership assets included under Section 2036 to avoid double taxation. The facts made the application of Section 2043 easy in Powell because the date of death was shortly after the date of the transfer of assets to the Family Limited Partnership.

The facts did not make the application of Section 2043 in Moore easy, because any increase or decrease in the value of the underlying assets in the Family Limited Partnership and the Family Limited Partnership interests themselves between the date of the transfer and the date of death must had to be taken into account. This causes a more complicated set of calculations.

The court then presented an equation to address the needed calculations, which read:

Vincluded = Cd + FMVd – Ct.

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

Cd = the date of death value of the consideration received by the decedent from the transaction that remains in his estate (Section 2033);

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

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

The court then went through five examples of how this formula would work and noted that depending upon the facts, some of the examples must seem odd; however, the court had to apply the Code as it was written and interpreted in the full decision of the Tax Court in Powell. The five examples were:

Example 1: Constant Values

Example 2: Inflating Values

Example 3: Declining Values

Example 4: Discounted Interest, But Simple

Example 5: Discounted Interest, But Not Simple

The court then noted that the Cd variable was not limited by tracing rules. Essentially, whatever is left of the original consideration in the estate is included but so also are the proceeds from a later sale because Section 2033 includes all property that the decedent owns in his gross estate on the date of death. As a result, property that leaves an estate after a transfer governed by Section 2036 but before the decedent’s death is generally not included in decedent’s gross estate. The court then went through an extensive analysis of the facts in this case and it noted that determining the value of four-fifths of the farm that went from the Living Trust to the Family Limited Partnership in exchange for an interest in the FLP was difficult. The estate valued Moore’s interest in the Family Limited Partnership at about $5.3 million. The IRS argued that it was worth $8.5 million.

After determining what the formula should be, but not the values that should be applied, the court then turned to the remaining issues.

The court also determined that the $500,000 “loans” by Moore to his children were” more likely than not” gifts. Some of the factors in making this determination were:

1. The notes had no fixed payment schedule;
2. The children paid no interest on the notes;
3. The children lacked the resources to pay off the notes;
4. The notes were not secured; and
5. The children did not set aside funds to repay the notes.

With respect to the availability of the estate tax charitable deduction for the distributions from the Living Trust to the charitable lead annuity trusts, the court held, based upon its review of the language, that the estate tax charitable deduction should be denied because the amount that would be transferred to charity could not be determined as of the date of death. The court then disallowed the deduction of the $475,000 of attorney’s fees for the administration of the estate (over and above the $320,000 in fees for the estate planning), because there was no evidence that the fees were reasonably incurred in the administration of the estate or if they were, why the fees were so high. It noted that while New York courts might at least consider the reasonableness of fees based on a percentage of the gross estate, Arizona law required a court to look at other evidence, including billable hours and the type of work performed and use good judgment to decide the weight to give to each factor.

In closing, the court noted that the computations under the equation that it had presented would be difficult.

* 1. **Letter Rulings 202014006 – 202014010 (Issued October 16, 2019; Released April 3, 2020); 202015005 – 202015013 (Issued October 12, 2019; Released April 10, 2020); 202017001 – 202017006 and 202017011 – 202017014 (Issued October 16, 2019; Released April 24, 2020)**

**Proposed changes will not ungrandfather pre-October 8, 1990 buy-sell agreement for purposes of Section 2703**

Prior to October 8, 1990, the effective date of Section 2703 as part of Chapter 14, certain shareholders of a company entered into a Stock Redemption and Buy-Sell Agreement (the “Agreement”). At the time, the Company had one class of common stock and one class of preferred stock.

Under the Agreement, the shares of stock could be transferred to lineal descendants of A and B and to trusts for the benefit of the spouse of a shareholder as long as the ultimate beneficiary of the trusts were lineal descendants of husband and wife, A and B. The Company had a right of first refusal if a shareholder or transferee of shares from a shareholder wished to encumber or dispose of shares in the Company (other than to lineal descendants or in trusts for the spouses of shareholders). The price was determined either by a formula or a price fixed by the shareholders. The shareholders of the Company were A and B, their three daughters, a trust for the benefit of the three daughters (the “Daughter Trust”) and trusts for the individual benefit of each of seven grandchildren and of which each grandchild was the sole beneficiary (the “Grandchild’s Trust”). Each Grandchild’s Trust terminated when the grandchild reached age 21.

After October 8, 1990, A and B died, shares of stock were distributed to grandchildren when a grandchild’s trust terminated, the company changed its name and made administrative changes such as the number of members of the Board of Directors, the first daughter created six GST Trusts funded with shares of stock for the initial benefit of her six living nieces and nephews, the second daughter created separate GST trusts for each of her three children to be funded with Company stock after the receipt of a favorable letter ruling, and the third daughter created separate GST trusts for each of her three children to be funded with Company stock after the receipt of a favorable letter ruling.

The Company proposed to cancel all shares of the common stock held in treasury and to recapitalize the Company so the newly issued voting stock would be primarily held by shareholders actively involved in the business and nonvoting stock would be held by the other shareholders. Subsequently, nonvoting stock would be transferred to the Grandchildren’s trusts.

The following rulings were sought in this series of letter rulings:

1. None of the transfers of the shares of the stock in the company after October 8, 1990 constituted substantial modifications to the agreement within the meaning of Treas. and the agreement would continue to be grandfathered for purposes of Chapter 14.
2. None of the amendments to the articles would subject the agreement to Chapter 14.
3. The proposed Plan of Recapitalization would not subject the agreement to Chapter 14.
4. The proposed transfers of non-voting common stock to the Grandchildren’s Trusts would not subject the agreement to Chapter 14.

Section 2703 provides that buy-sell agreements created after October 8, 1990 must provide for the use of a value that reflects the fair market value of the property for purposes of the estate, gift and generation transfer taxes. Otherwise, the value provided for in the buy-sell agreement will be ignored. A pre – October 8, 1990 agreement is grandfathered from Section 2703 if it is not substantially modified after that date.

The IRS first ruled that none of the transfers of Company Stock would constitute a substantial modification and the Agreement would continue to be grandfathered. An agreement will be treated as having been substantially modified if a family member assigned to a generation lower than those of the parties already subject to the agreement under Treas. Reg. § 25-2703-1(c). Here, the family members to whom transfers were or would be made were with the generation assignments of current shareholders.

The IRS next ruled that none of the modifications of the bylaws and articles would constitute substantial modifications under Treas. Reg. § 25-2703-1(c). The Service also ruled that that the Plan of Recapitalization into voting and nonvoting stock would not constitute substantial modifications under Treas. Reg. § 25-2703-1(c). Finally, the Service ruled that the proposed transfers of non-voting common stock to the Grandchildren’s Trusts would not constitute substantial modifications under Treas. Reg. § 25-2703-1(c).

Consequently, the Agreement would continue to be grandfathered from any application of Section 2703.

* 1. **Estate of Warne v. Commissioner, T. C. Memo 2021-17**

**Court determines valuation of LLC interests for gift tax, estate tax inclusion, and estate tax charitable deduction purposes and upholds penalties for late filing of gift tax return**

Thomas and Miriam Warne, who were residents of California, created the Warne Family Trust, a revocable joint trust for their benefit, in 1981. Over the subsequent years, the Family Trust became the majority interest holder of five limited liability companies:

1. WRW Properties LLC;

2. Warne Ranch, LLC;

3. VJK Properties, LLC;

4. Warne Investments LLC; and

5. Royal Gardens LLC.

Each of the LLCs held ground leases in various properties in California. The operating agreement of each of the LLCs provided the majority interest holder with considerable rights, including the ability with the manager to dissolve the LLC. Each operating agreement also put restrictions on the ability of a member to withdraw from the LLC. Thomas Warne died in 1999. Miriam Warne, as the trustee of the Family Trust, served as the managing member of each LLC.

On December 27, 2012, Miriam Warne gave fractional interests in three of the five LLCs to her two sons and three granddaughters. Miriam Warne subsequently died on February 20, 2014. Upon her death, the Family Trust, the assets of which were includable in Miriam Warne’s estate, owned the following percentage of each of the five LLCs:

1. WRW – 78%

2. Warne Ranch – 72.5%

3. VJK – 86.3%

4. Warne Investments – 87.432%; and

5. Royal Gardens – 100%

Under the terms of the Family Trust, Miriam Warne left 75 percent of Royal Gardens to the Warne Family Charitable Foundation and the remaining 25 percent to St. John’s Lutheran Church. The balance of the Family Trust assets appears to have passed to or for the benefit of family members.

On May 19, 2015, the estate filed the gift tax return for the 2012 gifts that Miriam Warne made to each of her two sons and three granddaughters. The estate tax return was timely filed, also on May 19, 2015. Discounts were taken for lack of marketability and lack of control in valuing the interests of the Family Trust in the LLCs. With respect to the gift of the interest in Royal Farms, the estate use the same value for the gross estate and for the combine fractional interests passing to the two charities.

The IRS challenged both the gift tax and estate tax valuations. On the gift tax return, the IRS increased the values of the interests in the three LLCs given in 2012. The IRS also imposed a penalty for the late filing of the gift tax return. On the estate tax return, the IRS determined a $8,351,970 deficiency. This was due to increases in the value of the LLCs and a reduction for the charitable deduction for the Royal Gardens gifts to the fractional value of each gift rather than the pro rata share of the value at which Royal Gardens was reported for purposes of determining the gross estate.

During the proceedings, the estate’s expert, Philip Schwab, concluded that there should be a 10 percent total discount for lack of control and lack of marketability while the IRS’s expert concluded there should be a 4 percent total discount for lack of control and lack of marketability with respect to the LLCs other than Royal Gardens.

With the respect to Royal Gardens, the estate and the IRS stipulated that the value was $25,600,000 for inclusion in the estate. The parties conditionally stipulated that with respect to the estate tax charitable deduction, if the court decided that a discount was appropriate for the 25 percent contribution of Royal Gardens to the church, the discount would be 27.385 percent for a total value of $4,650,000. The parties also conditionally stipulated that the 75 percent interest of Royal Gardens donated to the foundation should have a discount of 4 percent and a total value of $18,443,000 if the court decided that a discount was appropriate.

The court indicated the following issues were to be decided.

1. The fair market values of the leased fee interest as of the date of the gift;

2. The fair market values of the leased fee interest as of the date of Miriam Warne’s death;

3. The appropriate discounts for lack of control and marketability for the majority interest that the Family Trust held in the LLCs;

4. Whether to apply a discount to the separate fractional interests in Royal Gardens donated to the two charities; and

5. Whether the penalty for late filing of the gift tax return would apply.

With respect to the different valuation issues, the court found flaws in the analysis of each of the estate’s experts and the IRS’s experts and took a middle ground. In a lengthy discussion, it concluded that discounts for lack of control of 4 percent and lack of marketability of 5 percent for the LLCs were appropriate.

On the calculation of the estate tax charitable deduction, the court found, based on its reading of Ahmanson Foundation v. United States, 674 F.2d 761 (9th Cir. 1981), that Royal Farms should be included in the estate at its full value. This is because nothing in the statutes or case law suggests that the valuation of the gross estate should take into account the fact that the assets will come to rest in several hands rather than one. The value of an asset as part of an estate is determined without regard to the later disposition of that asset.

However, when property is split as part of charitable contribution, a different principle applies for purposes of determining the estate tax charitable deduction. An estate may only take an estate tax charitable deduction for what the charity actually receives. Another way of putting this was that for purposes of the estate tax charitable deduction one does not value what the estate contributed, one values what each of the charities received. As a result, the estate had to include 100 percent of Royal Gardens in the value of the gross estate. Because the discount applied to the charitable contribution deduction, the court accepted the 27.385 percent discount for the 25 percent interest given to the church and the 4 percent discount for the interest given to the family foundation to which the parties conditionally stipulated.

The court upheld the penalty for the late filing of the gift tax return. It noted that the gift tax return for the 2012 gift was due by April 15, 2013. The estate filed the gift tax return on May 19, 2015 without requesting an extension. As a result, the filing was late. Although the estate claimed that Miriam Warne had reasonable cause for the late filing, it produced no evidence in support of this. This caused an addition to tax to apply under Section 6651(a)(1).

* 1. **Estate of Michael J. Jackson the Commissioner, T.C. Memo 2021-48**

**Tax court rules on estate tax values of Michael Jackson's likeness and image, 50 percent stake in Sony/ATV Music Publishing, and compositions written or co-written by Jackson**

In an extraordinarily detailed and lengthy opinion, Judge Holmes of the Tax Court decided three issues related to the valuation of assets in the estate of legendary musician, Michael Jackson, who died on June 25, 2009. The three assets on which the estate and the IRS disagreed on the value were:

1. Jackson's image and likeness;

2. Jackson's interest in New Horizon Trust II (“NHT II”), through which he held a 50 percent interest in Sony/ATV Music Publishing, LLC (which owned the John Lennon-Paul McCartney music catalogue); and

3. Jackson’s interest in New Horizon Trust III (“NHT III”) which contained MiJack Music, a music publishing catalog that owned the copyrights to compositions that Jackson wrote or co-wrote as well as compositions by other songwriters.

The opinion first discusses Michael Jackson's life and career in length. At the time of his death, each of the three disputed assets were distressed. His image and likeness were producing no noticeable income and Jackson had not even been able to contract for the sale of tour merchandise containing his image and likeness because of the damage done by various allegations, law suits, and court trials related to Jackson’s personal life. Jackson’s interest in Sony/ATV secured $303,000,000 in loans with maturity dates less than 18 months away. Jackson's interests in MiJack secured over $72,000,000 in debt. The “This Is It” tour which was view as a the way to turn around the decline in Jackon’s career was in rehearsal when he died.

After his death, John Branca, an entertainment lawyer and longtime advisor who had recently returned after a falling out with Jackson several years prior, was one of the co-executors. He and other advisors went to work to shore up the estate’s troubled finances. As the court noted:

"What Jackson had created during his lifetime was now fixed and it was to the considerable benefit of the estate that he was no longer able to get in the way of the rational profit maximizers who were now in control. And nearly everyone involved in these early days after Jackson's death turned out to be accomplished in the business side of the entertainment business. As crass as it might have seen to Jackson's more sentimental fans, the business began almost immediately."

One of the efforts of the executors was the creation of the documentary "Michael Jackson's This Is It," derived from videos of Jackson's rehearsals for the This Is It tour. The success of that film was unprecedented and as of July 2011, the movie generated cumulative gross receipts of over $240,000,000. There were subsequent deals with Cirque du Soleil as well as various other ventures and deals. For example Sony acquired the estate’s 50 percent interest in Sony/ATV and became the 100 percent owner for a price of $750,000,000.

In preparing the federal estate tax return, the estate retained Moss Adams, a large accounting consulting firm, to value Jackson's image and likeness and his interest in MiJack. Relying entirely on the income approach to valuation, Moss Adams valued Jackson's image and likeness at $2,105 and MiJack at $70,860,000. The estate used the Salter Group, an independent financial and strategic advisory firm to value the 50 percent ownership interest in Sony/ATV. The Salter Group used only the income method by which it valued Jackson's ownership interest in Sony/ATV at $0. Based on these appraisals, the estate reported the value of Jackson's image and likeness at $2,105, NHT II, which held his 50 percent interest in Sony/ATV at $0 and NHT III, which held MiJack, at $2,207,351.

The IRS on audit greatly increased the estate’s reported values when it issued a notice of deficiency in May 2013. The IRS’s values were:

Image and Likeness $434,261,895

NHT II $469,005,086

NHT III $58,478,593

The adjusted valuation led the IRS to conclude that the estate underpaid Jackson’s estate tax by more than $500 million. The IRS also tacked on undervaluation penalties of nearly $200 million.

After lengthy negotiations the estate and the IRS were unable to agree on the valuation of the image and likeness, ATV/Sony (held in NHT II), and MiJack (held in NHT III).

The estate used four experts at trial. Mark Roesler, the founder and CEO of CMG Worldwide Inc., an international licensing and rights management company, and Jay Fishman, a professional business valuation appraiser, valued Jackson’s image and likeness. Fishman came up with a value of about $3 million instead of $2,105 for the value of the image and likeness.

Alan Wallis, who led the Media and Entertainment Group in Ernst & Young’s UK valuation practice, to value Jackson’s interest in Sony/ATV. Wallis valued the Sony/ATV interest, using both the market approach and the income approach. Both approaches led Wallis to conclude, after taking account of debt secured by Jackson’s interest in Sony/ATV, NHTII was worth nothing.

Owen Dahl, who had a great deal of experience in valuing high-profile music catalogs, valued Jackson’s interest in MiJack Music. Dahl concluded that the fair market value of NHTIII was about $2.7 million.

Each of the estate’s experts and their valuations reduced the cash flows produced by the assets using tax affecting to take account of the tax implications to a hypothetical buyer.

The IRS used Weston Ansen, the Chairman of Consor Intellectual Asset Management, to value all three assets. To value Jackson’s image and likeness, Ansen considered five “opportunities” that he believed a hypothetical buyer could reasonably foresee at Jackson’s death (themed attractions and products, branded merchandise, a Cirque du Soleil show, a film, and a Broadway musical). Using the income approach, Ansen valued Jackson’s image and likeness at $161 million. Ansen valued Jackson’s interest in Sony/ATV using both the income and market approaches and valued NHTII at $206 million. Ansen valued Jackson’s interest in MiJack using only the income approach and valued NHT III at $114 million.

Ansen’s credibility suffered greatly at trial. During trial, he indicated that he had never worked for the IRS before. Ansen had to correct that misstatement because he had prepared a valuation report on the fair market value of Whitney Houston’s intangible property rights for the IRS. He also testified that neither he nor his firm ever advertised to promote his business, which was also a misstatement because, in the midst of the trial, Ansen’s firm touted his testimony in an email blast to clients and others.

In a lengthy evaluation of all the appraisals, the court reached the following determination as to the value of the three interests. Jackson’s image and likeness was worth $4,153,912, NHTII (Sony/ATV) was worth $0, and NHTIII (MiJack Music) was worth $107,313,561.

Although the estate had undervalued the assets by approximately $111,000,000, the court declined to impose any undervaluation penalties.

**CHARITABLE GIFTS**

* 1. **Hoffman Properties II, LP v. Commissioner, \_\_\_\_\_ F.3d \_\_\_\_\_ (6th Cir. 2020)**

**Ability of donor to make changes to donated charitable easement whenever the donee fails to act within 45 days of notice of the proposed change violates the requirement that donation be perpetual**

This was an appeal from the decision of the Tax Court.

Hoffman Properties owned a historic building in Cleveland, Ohio. Over ten years ago, Hoffman donated an easement in the façade of the building and certain airspace restrictions to the American Association of Historic Preservation “AAHP”). Under the conservation easement, Hoffman agreed not to alter the historic character of the façade or to build in the airspace above or next to the building. Hoffman then sought a $15 million income tax charitable deduction.

The IRS concluded that Hoffman was not entitled to an income tax charitable deduction because the donation was not “exclusively for conservation purposes” and did not meet the requirements for a “qualified conservation contribution” under Section 170(f)(3)(B)(iii). In later proceedings, the Tax Court agreed and granted summary judgment to the IRS. The Tax Court found that Hoffman’s donation failed multiple requirements for a donation to be considered “exclusively for conservation purposes” under Section 170(h)(4)(B). The Sixth Circuit considered only one, which is that the conservation purposes must be protected in perpetuity under Section 170(h)(5)(A).

Hoffman reserved the right to make certain changes so long as the AAHP approved. AAHP’s failure to act within 45 days of a receipt of a proposed change would be deemed to constitute approval and to permit Hoffman to undertake the proposed actions. In other words, Hoffman gave AAHP a 45-day window in which to prevent changes in the façade or airspace. The court then stated that “it almost goes without saying that this provision violated the perpetuities requirement.”

Hoffman made several arguments, which the Sixth Circuit declined to accept. For example, Hoffman argued that the case fell within the narrow exception of the perpetuity requirement for remote future events. To fall within this exception, the possibility that the conservation purpose may be defeated must be “so remote as to be negligible.” However, the Sixth Circuit interpreted the donation agreement as containing multiple terms that specifically addressed the possibility that the conservation purpose would be defeated. As a result, the decision of the Tax Court was upheld.

* 1. **AM 2020-001 (Issued March 17, 2020; Released March 27, 2020)**

**IRS provides legal advice on amendment clauses for conservation easement deed**

The issue in this memorandum from the Office of Chief Counsel of the Internal Revenue Service was whether a conservation easement failed to satisfy the requirements of Section 170(h) of the Internal Revenue Code as a matter of law if it contained an amendment clause.

The memorandum first noted that many cases involving the disallowance of an income tax charitable deduction for the contribution of a conservation easement are pending at the IRS. A significant number of these cases contain issues concerning the interpretation of the terms of the transfer deed and the effect of certain clauses including amendment clauses.

Section 170(h) provides various rules concerning qualified conservation contributions. To qualify, a contribution of a conservation easement must be used exclusively for conservation purposes. However, a contribution will not be treated as being used exclusively for conservation purposes unless the conservation purpose is protected in perpetuity.

An amendment clause must be considered in the context of the terms of the deed as a whole and the surrounding facts and circumstances to determine the rights, powers, obligations and duties of the parties on a case by case basis.

The memorandum noted that the following provision complies with the perpetuities requirements of Section 170(h):

Grantee and Grantor may amend this easement to enhance the Property’s conservation values or add real property subject to the restrictions set forth in this deed to the real property by an amended deed of easement provided that no amendment shall (i) affect this Easement’s perpetual duration, (ii) permit development, improvements or uses prohibited by this Easement on its effective date, (iii) conflict with or be contrary to or inconsistent with the conservation purposes of this Easement, (iv) reduce the protection of the conservation values, (v) affect the qualification of this Easement as a “qualified conservation contribution” or “interest in land”, (vi) affect the status of the Grantee as a “qualified organization” or “eligible donee”, or (vii) create an impermissible private benefit or private inurement in violation of federal tax law…

This is one example of the increasing scrutiny that the IRS is giving to conservation easements.

* 1. **I.R. 2019-182 (November 12, 2019)**

**IRS increases enforcement actions for Syndicated Conservation Easements**

The Internal Revenue Service announced what it called “a significant increase in enforcement actions for syndicated conservation easement transactions, a priority compliance area for the agency”, on November 12, 2019. It noted that coordinated examinations are being conducted across the IRS in the small business and self-employed division, the large business and international division, and the tax exempt and government entities division. Separate investigations have also been initiated by the IRS’s criminal investigation division. According to the IRS, these audits and investigations cover billions of dollars of potentially inflated deductions as well as hundreds of partnerships and thousands of investors.

As the IRS put it:

We will not stop in our pursuant of everyone involved in the creation, marketing, promotion and wrongful acquisition of artificial, highly inflated deductions based on these aggressive transactions. Every available enforcement auction will be considered, including civil penalties and, where appropriate, criminal investigations.

In Notice 2017-10 (December 2016) the IRS designated certain syndicated conservation easements as listed transactions. In specific, that notice listed transactions where investors and pass through entities received promotional material offering the possibility of charitable contribution deduction worth at least two and at one half times their investment. In many transactions, the deduction taken was significantly higher than 250 percent of the investment. These transactions are included on the IRS’s 2019 “dirty dozen” list of tax scams to avoid. The IRS recognized that there are many legitimate conservation easements and that its compliance efforts were focused on the abusive syndicated conservation easement transactions. The IRS noted that it is pursuing investigations not only of participants, but also of promoters, appraisers, tax return preparers and others and will develop and assert all appropriate penalties. Such penalties include accuracy related penalties for participants, penalties for substantial and gross valuation misstatements attributable to incorrect appraisals for appraisers, and promoters. The IRS also noted that it is litigating cases where necessary with more than 80 currently docketed cases in the Tax Court on the availability and amount of income tax charitable deductions with respect to conservation easements.

* 1. **Village at Effingham, v. Commissioner, T.C. Memo 2020-102; Riverside Place LLC v. Commissioner, T.C. Memo 2020-103; Maple Landing, LLC v. Commissioner, T.C. Memo 2020-104; and Englewood Place, LLC v. Commissioner, T.C. Memo 2020-105**

**Tax court denies income tax charitable deduction for donations of conservation easements**

Each of these cases involve motions or cross-motions for partial summary judgment with respect to similar facts involving the same parties. In each case, a Georgia limited liability company had its principal place of business in Georgia. In December 2008, each LLC acquired a tract of land in Effingham County, Georgia from HRH Investments, LLC. Subsequently, in December 2010, each LLC donated a conservation easement over a specific number of acres of land to the Georgia Land Trust.

Each easement deed recited the conservation purposes and generally prohibited commercial residential developments. Each deed recognized the possibility that the easement might be extinguished at some future date. If the property were sold following that extinguishment, “the amount of the proceeds to which grantee shall be entitled, after the satisfaction of any and all prior claims, shall be determined, unless otherwise provided by Georgia law, in accordance with the Proceeds paragraph.” The Proceeds paragraph specified that the grantee’s share of any future proceeds would be determined by multiplying the fair market value of the property unencumbered by the conservation easement (minus any increase in value after the date of the conservation easement attributable to improvements) by the ratio of the value of the conservation easement at the time of the conveyance to the value of the property at the time of the conveyance without the deduction for the value of the conservation easement. A substantial income tax charitable deduction was taken for each donation. The deduction for the Village of Effingham was $5,237,000. The deduction for Riverside Place was $4,071,000. The deduction for Maple Landing was $6,791.000. The deduction for Englewood Place was $4,773,000.

The appraisal for the value of the easement was prepared by David R. Roberts. A Form 8283, Non-Cash Charitable Contribution, executed by David Roberts and the Georgia Land Trust was included with each LLC’s income tax return. The Form 8283 stated that the basis of the donor in the property was not included because the basis of the property was not taken into consideration by the appraiser in computing the amount of the deduction.

The IRS denied the income tax charitable deductions and the parties filed cross-motions for partial summary judgment. The IRS asserted that the conservation purposes underlying the easement were not protected in perpetuity because the easement failed to comply with the regulations governing judicial extinguishment under Treas. Reg. § 1.170A-14(g)(6). The IRS also asserted that each LLC failed to attach a fully-completed appraisal summary on the Form 8283 because the appraisal summary did not include the donor’s basis in the property. Each LLC stated that it had complied with regulatory requirements or if it had not, the regulations imposing the requirements related to inclusion of the basis were invalid.

The court rejected each LLC’s arguments as it had done in previous cases involving substantially similar deeds of easement. It noted that the formula used to determine the grantee’s proportionate share of post extinguishment proceeds was applied not to the full sale proceeds but to the proceeds minus any increase in value after the date of the easement attributable to improvements. This was an improper reduction and violated the requirement that easement be protected in perpetuity. If there was an extinguishment, the charitable donee must get its full share of the proceeds. The court also noted that the grantee’s share of the proceeds would be further reduced through the satisfaction of any and all prior claims. This caused all prior claims to be assessed against the grantee’s share of the proceeds even if those claims represented liabilities of the LLC or its successors.

The court next rejected the argument that the regulation on extinguishment was invalid. The court noted that it had addressed and rejected both arguments in a previous Tax Court-reviewed opinion. As a result, the conservation purpose underlying the easement was not protected in perpetuity as required by Section 170(h)(5)(A).

In addition, the court addressed the IRS’ position that each LLC’s income tax charitable deduction should be disallowed because of its failure to attach a properly completed appraisal summary. The court held that each LLC did not substantially comply because its failure to supply cost basis violated the essence of the statute. The disclosure of the donor’s cost basis is an essential tool that Congress intended the IRS to have in the efficient identification of overvalued property. The court also rejected each LLC’s contention that the regulations requiring disclosure of cost and other basis on the appraisal summary is invalid. As a result, the income tax charitable deduction for each of the LLCs conservation easements was denied.

* 1. **Dickinson v. Commissioner, T.C. Memo 2020-128**

**Tax Court finds that donation of privately held company stock to donor advised fund was completed gift and assignment of income doctrine did not apply**

This case was before the Tax Court on a motion for summary judgment by husband and wife, the taxpayers, and on a cross-motion for partial summary judgment by the government.

Husband was the chief financial officer and a shareholder of Geosyntec Consultants, Inc (“GCI”), a privately held company. In each of 2013 through 2015, the board of directors of GCI authorized shareholders to donate shares in GCI to the Fidelity Investments Charitable Gift Fund (“Fund”). In consenting to permitting the donations, the Board noted that the Fund “is a Donor Advised Fund which incorporates procedures requiring the Fund to immediately liquidate the donated stock” and “seeks an imminent exit strategy and, therefore, promptly tenders the donated stock to the issuer for cash.”

In each of the years in which the Board authorized the donations of stock to the Fund, husband donated appreciated shares to the Fund. GCI confirmed in letters to the Fund that its books and records reflected the Fund as the new owner of the shares. For each stock donation, husband signed a letter of understanding to the Fund indicating that the transferred stock was exclusively owned and controlled by the Fund and that the Fund maintained full discretion over all conditions of any subsequent sale of the stock and was not under any obligation to redeem, sell, or otherwise transfer the stock. Husband and wife received confirmation letters from the Fund, which explained that the Fund had “exclusive legal control over the contributed asset.” Shortly after each donation, the Fund redeemed the GCI shares for cash.

When husband and wife claimed an income tax charitable contribution deduction for each of 2013, 2014, and 2015, the IRS determined that the petitioners were liable for tax on the redemption of the shares and applied a Section 6662(a) 20 percent underpayment penalty. The IRS argued that each donation of the GCI shares, followed by the Fund’s exchange of the shares for cash, should be treated as a taxable redemption of the shares for cash by husband, followed by the donation of the cash proceeds to the Fund.

The court analyzed this case under the two-pronged test of Humacid Co. v. Commissioner, 42 T.C. 894 (1964), to see if these transactions should be respected. The first prong of the Humacid test is that the donor must give the property absolutely and part with title thereto. The second prong of the Humacid test is that the gift by the donor must occur before the property gives rise to income by way of a sale.

In applying the first Humacid prong, the court had to determine whether husband transferred all of his rights in the donated property. The court found that GCI’s letters to the Fund confirming the ownership transfer, the Fund’s letters to husband and wife explaining that the Fund had exclusive legal control over the donated stock, and the letters of understanding to the same effect supported the claim that husband transferred all his rights in the shares. Consequently, because husband and wife had contemporaneous documentary evidence of an absolute gift and the government failed to assert facts indicating any genuine controversy on this point, the court concluded that the first Humacid prong was met.

The second Humacid requirement is that the taxpayer make the donation before the stock gives rise to income by way of a sale. This involves the assignment of income doctrine. Under the assignment of income doctrine, a taxpayer who has earned income cannot escape taxation by assigning his or her right to receive payment. Helvering v. Horst, 311 U.S. 112 (1940). The second Humacid prong ensures that if stock is about to be acquired by the issuing corporation via redemption, a shareholder cannot avoid tax on the transaction by donating the stock before the shareholder receives the proceeds.

The court, citing Palmer v. Commissioner, 62 T.C. 684 (1974), aff’d 523 F.2d 1308 (8th Cir. 1975), stated that the assignment of income doctrine applies only if the redemption was practically certain to occur at the time of the gift and would have occurred whether the shareholder made the gift or not. The court noted that there was no assignment of income in Palmer, even though all parties were related and anticipated the redemption before the donation, because no vote for the redemption had yet been taken when the shareholder donated his stock. The facts in this case were similar. The redemption was not a *fait accompli* when the gift was made. This was not a situation such as that in Ferguson v. Commissioner, 174 F.3d 997 (9th Cir. 1999) where the court found that the shareholder recognized income from a stock sale when the acquisition is “practically certain to occur,” rather than the subject of “a mere anticipation or expectation” before the shareholder donated stock.

The court also noted that it had not adopted the “bright-line” rule of Revenue Ruling 78-197, 1978-1 C.B. 83, under which the IRS in cases like Palmer focuses on the donee’s control over the appreciated property. Instead, the ultimate question is whether the redemption and the shareholder’s corresponding right to income had already crystalized at the time of the gift. Regardless of whether the donee’s obligation to redeem the stock may suggest that the donor had a fixed right to redemption income at the time of the donation, the IRS did not allege that husband had any such right in this case.

Because both prongs of the Humacid test were met, the court granted husband and wife’s motion for summary judgment to allow them to take the income tax charitable deduction for the gift of the stock to the Fund. The court also denied the government’s motion for partial summary judgment.

**GENERATION-SKIPPING TRANSFER TAX**

* 1. **Letter Rulings 202011001 to 202011005 (Issued October 7, 2019; Released March 13, 2020) and 202013001 to 202013005 (Issued October 7, 2019; Released March 27, 2020)**

**Proposed modification of GST grandfathered trust will not have adverse generation-skipping tax consequences**

Father and Mother created an irrevocable trust for the benefit of their Son prior to September 25, 1985 that would last until twenty-one years after the death of Son. Consequently, the trust was grandfathered from the GST tax. Subsequently, a local court approved a settlement agreement that provided that the trust would be partitioned into two separate trusts, Trust A and Trust B. With the exception of Son’s wife, the beneficiaries of Trust A were different from the beneficiaries of Trust B. Son and his wife also released any power of appointment that they may have had over Trust A. Subsequently, the trustee of Trust A petitioned the local court to modify Trust A to provide that upon Son’s death, Trust A was divided into separate shares for his heirs. Son’s wife would receive one-third of Trust A and the other two-thirds would be divided into shares for the descendants of Son.

Son died and as a result of Son’s death and various disclaimers, nine separate trusts were created from Trust A. Subsequent to Son’s death, the trustees and advisory board members of Trust A and the successor trusts petitioned the local court to modify the trust to provide that if property is distributed upon the termination of Trust A to beneficiaries who had not reached a certain age, the trustee could make payment or distribution of that property to a vested continuing trust for the beneficiary. One-half of the assets of the continuing trust would be distributed to the beneficiary at a specific age and the balance at a subsequent age. Each beneficiary was given a testamentary general power of appointment. If the continuing beneficiary failed to exercise the general power of appointment, the property in the continuing trust would be distributed to the estate of the continuing beneficiary.

The trustees requested a ruling that the proposed modification would not cause Trust A or its successor trusts to lose their grandfathered exemption from GST tax.

In this ruling, Trust A was irrevocable prior to September 25, 1985. The amended trust agreement provided for outright distributions to the beneficiaries upon the termination of the trust and the successor trusts, which would occur 21 years after the death of Son. Each share upon the termination of Trust A or a successor trust distributed to a beneficiary under a particular age would be held in a vested trust for that beneficiary. The proposed modification would not result in the shift of any beneficial interest of any beneficiary who occupied a generation lower than persons holding the beneficial interests. The proposed modification would not extend the time for vesting of any beneficial interest in any trust. Thus, the modification fell within the parameters of Treas. Reg. § 26.2601-1(b)(4)(i)(D)(1) which provides that a modification in the governing instrument of an exempt trust by judicial reformation will not cause an exempt trust to be subject to generation-skipping tax if the modification does not shift a beneficial interest in the trust to a beneficiary who occupies a lower generation than the person or persons who held the interest prior to the modification and the modification does not extend the time for the vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

Since the requirements were met, the IRS ruled that the amendment of the trust would not ungrandfather the trust for generation-skipping tax purposes.

* 1. **Letter Rulings 202116002, 202116003, and 202116004, (Issued July 13, 2020; Released April 23, 2021)**

**Amendment of trust pursuant to state court order will not cause grandfathered trust to lose GST tax exempt status or otherwise be subject to GST tax**

Donor created a trust prior to September 25, 1985 that consequently was grandfathered from the GST tax. The trust was for the benefit of spouse and issue. Upon the death of spouse, the trustees were to divide the trust on a per stirpital basis into separate trusts for then living children and the issue of deceased children. The trustees were authorized to pay the net income from each trust to each child and the issue of the deceased child at least quarterly. The trustees could distribute principal for the education for the beneficiary and for any medical, surgical, hospital or other institutional care. Upon the death of a child, the property in the child’s trust would be divided into separate trusts for that child’s issue on a per stirpital basis. Each trust would terminate when a great grandchild’s share terminated.

The beneficiaries requested a court order, contingent on obtaining a favorable private letter ruling, to amend the trust to create separate trusts for each grandchild (descended from the deceased child) or the issue of a deceased grandchild at each child’s death. The amended trust would also provide that the termination date for each trust would be the later of the death of the grandchild for whom the trust was set apart and the date on which no living beneficiary of such trust was a great grandchild of the donor or was under a set age as long as the rule against perpetuities was not violated. The following rulings were requested:

1. The amendment to the trust would not cause a loss of the GST exempt status.

2. The amendment to the trust would not cause any beneficiary to be treated as having made a gift of any portion of the trust.

3. The amendment to the trust would not cause any portion of the original trust to be included in the gross estate of any beneficiary.

4. The amendment to the trust would not give rise to any taxable income or cause a beneficiary to recognize gain or loss from a sale or other disposition of property.

The IRS noted that an examination of the relevant trust instruments, affidavits, and representations indicated that the donor intended for the trust property be held in trust for future generations, to be divided into separate trusts for each grandchild upon a child’s death, and to benefit a child’s family line as long as there were descendants living in that family line. This intent was not carried out in the trust instrument due to a scrivener’s error. The proposed court action would correct this error.

Moreover, the proposed court action was consistent with applicable state law that would be applied by the highest court of the state. As a result, the proposed amendment through the order of a state court would not cause the trust to lose its exempt status. Treas. Reg. § 26.2601-1(b)(4)(i)(C) provides that the judicial construction of a governing instrument to resolve an ambiguity in the terms of the instrument or to correct a scrivener’s error will not cause an exempt trust to be subject to GST tax if the judicial action involves a bona fide issue and the construction is consistent with applicable tax law that would be applied by the highest court of the state under the test in Commissioner v. Estate of Bosch, 387 U.S. 456 (1967). These requirements were met.

The IRS then ruled that the proposed amendment to the trust would not cause any beneficiary to be treated as making a taxable gift of any portion of the original trust upon the modification, the proposed amendment would not cause any portion of the original trust to be includable in the gross estate of any beneficiary prior to termination; and that there would be no adverse income tax consequences as a result of the amendment.

* 1. **Letter Ruling 202120003 (Issued October 22, 2020; Released May 21, 2021)**

**IRS rules that beneficiary’s exercise of limited power of appointment over grandfathered GST trust will have no adverse estate or generation-skipping tax consequences**

Son was the beneficiary of a grandfathered generation-skipping trust created prior to September 25, 1985. The son proposed to exercise a limited testamentary power of appointment over the trust assets to divide the property, per stirpes, into separate trusts for his three children. The son also proposed to provide a lifetime limited power of appointment to charity and a testamentary broad limited power to anyone other than the estate, the creditors of the estate, and the creditors of the holder of the power for each child or grandchild for whom a trust was created at the son’s death. Any exercise of a special power of appointment would be subject to the existing perpetuities provisions for the trust. The trust was subject to a set perpetuities period. The trust terms required a corporate trustee.

The son requested two rulings.

1. The son’s proposed exercise of the testamentary limited power of appointment would not cause the property in the grandfathered trust to be included in the son’s estate for estate tax purposes.

2. The son’s proposed exercise of the testamentary limited power of appointment would not subject the trust or the property transferred to generation-skipping tax.

With respect to the first request, the son had a broad limited testamentary power of appointment to and among such persons and/or charitable organizations as he shall see fit. The trust expressly provided, however, that the son could not exercise the testamentary power of appointment in favor of himself, his creditors, his estate, the creditors of the estate. As a result, the son’s testamentary power of appointment was not a general power of appointment under Section 2041(a)(2). The possession of this power would not cause inclusion of the trust of the son’s estate for estate tax purposes.

The son also had a power to remove the current or successor trustee, which had to be a national bank but he did not have the power to appoint a successor bank trustee of the trust. Thus, the son lacked any control over a bank trustee. This power of removal was not within the definition of a general power of appointment.

On the second request, the two requirements of Treas. Reg. § 26.2601-1(b)(1)(v)(B) to avoid adverse generation-skipping tax consequences were met (the limited power was created in an irrevocable trust and the exercise could not extend the existing perpetuities period). The power was not a general power of appointment and the power of appointment would not be exercised in a manner that might postpone or suspend the vesting of the trust or the successor trusts for a period beyond the existing perpetuities period. The ruling noted that son’s proposed exercise of the power of appointment would create powers of appointment over the property in the successor trusts. However, those powers would not postpone or suspend the vesting of any interest in the successor trust beyond the existing perpetuities period.

* 1. **Letter Rulings 202017009 and 202017010 (Issued November 25, 2019; Released April 24, 2020)**

**Service grants donor and spouse extension of time to opt out of automatic allocation of GST exemption**

Donor and spouse created five irrevocable trusts. Each trust was for the benefit of a single beneficiary and had GST potential. Donor and spouse split the gifts. Donor and spouse relied upon an attorney at the family office to prepare the gift tax returns reporting the transfers of property to the trusts. The attorney failed to advise the taxpayers of the rules regarding the automatic allocation of GST exemption under Section 2632(c) and the ability to opt out of the automatic allocation of GST exemption by making an election on the gift tax returns. As a result, GST exemption was automatically allocated to the trusts.

The taxpayers requested an extension of time under Treas. Reg. § 301.9100-1 and 301.9100-3 to elect out of the automatic allocation of GST exemption to the five trusts and the Service granted the request. Under Treas. Reg. § 301-9100-3, a request for relief will be granted when the taxpayer shows that the taxpayer acted reasonably and in good faith and the grant of relief will not prejudice the interests of the government. A taxpayer is deemed to have acted reasonably and in good faith when the taxpayer reasonably relied on a tax professional and the tax professional failed to make or advise the taxpayer to make an election. The Service found that this standard had been met in the fact situation in these rulings.

* 1. **Letter Rulings 202107001 and 202107002 (Issued June 30, 2020; Released February 19, 2021)**

**Service grants taxpayer and spouse extensions of time to opt out of automatic allocation rules for GST exemption**

In each of these letter rulings, Taxpayer and spouse created an irrevocable family trust with GST Tax potential for the benefit of their issue. Apparently, at the time of the creation of the family trust, Taxpayer and Spouse had no children. Taxpayer also established a grantor retained annuity trust (“GRAT”) in the same year and funded the GRAT with limited partnership interests in one entity. The terms of the GRAT provided that upon termination of the taxpayer’s retained annuity interest, the assets remaining in the GRAT passed to the family trust. The taxpayer survived the annuity term and the assets in the GRAT passed to the family trust. For purposes of the GST Tax, the estate tax inclusion period (“ETIP”) ended upon the termination of taxpayer’s retained interest and part of the taxpayer’s GST exemption was automatically allocated to the family trust pursuant to Section 2632(c)(1).

Taxpayer and spouse, having created the family trust primarily for the benefit of their children, did not intend to for the trust to provide benefits for any potential grandchildren. Spouse also created a GRAT that paid out the remainder interest to the family trust upon the termination of the Spouse’s annuity interest.

The lawyer who advised the taxpayer and the spouse on the creation and funding of the family trust and the two GRATs failed to advise the taxpayer and the spouse about the automatic allocation rules of Section 2632(c) and the ability to opt out of the automatic allocation rules by making that election on a gift tax return. Neither the taxpayer nor the spouse made the opt-out election on a gift tax return.

The taxpayer requested an extension of time to opt out of the automatic allocation rules pursuant to Sections 2642(g) and Treas. Reg. § 301.9100-3. Under Treas. Reg. § 301-9100-3, a request for relief will be granted when the taxpayer shows that the taxpayer acted reasonably and in good faith and the grant of relief will not prejudice the interests of the government. A taxpayer is deemed to have acted reasonably and in good faith when the taxpayer reasonably relied on a tax professional and the tax professional failed to make or advise the taxpayer to make an election. The Service found that this standard had been met in the fact situation in each of these rulings and provided an extension of time for the making of the election to opt out of the automatic allocation rules.

* 1. **Letter Rulings 202117002 and 202117003 (Issued July 14, 2020; Released April 30, 2021)**

**IRS grants extension of time to opt out of automatic allocation rules for GST exemption**

These two letter rulings involve a situation in which the taxpayer and spouse establish separate irrevocable trusts, one for their daughter and one for their son. Funds were transferred to each of the two irrevocable trusts and each trust had GST potential.

In addition, each taxpayer established three irrevocable Grantor Retained Annuity Trusts (GRATs). Each GRAT had either a two- or three-year annuity term. At the end of the annuity term, the property in each GRAT passed to the separate irrevocable trusts for the daughter and the son which had GST potential. The ETIP period for each GRAT would end upon the conclusion of the annuity term.

The taxpayers retained an attorney and an accountant to provide tax advice. Neither the attorney nor the accountant advised the taxpayer of the rules under Section 2632(c) regarding the automatic allocation of GST exemption to trusts with GST tax potential and the ability to elect out of the automatic allocation rules. Because the taxpayer failed to opt out of the automatic allocation rules, GST exemption was automatically allocated to the two irrevocable trusts and the GRATs

The taxpayer requested an extension of time to opt out of the automatic allocation rules.

The IRS granted the request for an extension of time to opt out of the automatic allocation rules Section 2642(g) permits the granting of an extension of time if all relevant circumstances are taken into account. Under Treas. Reg. § 301-9100-3, an extension of time to opt out of the automatic allocation rules may be granted when the taxpayer proves to the IRS that the taxpayer acted reasonably and in good faith and that the grant of the relief will not prejudice the interests of the government. A taxpayer is deemed to have acted reasonably and in good faith if the taxpayer relied on a tax professional and the tax professional failed to make or advise the taxpayer to make the election. Those requirements had been met in this case and the IRS granted an extension of time to opt out of the automatic allocations of GST exemption.

* 1. **Letter Ruling 202133008 (Issued April 16, 2021; Released August 20, 2021)**

**IRS grants request for extension of time to opt out of the automatic allocation rules for GST exemption**

Grantor established an irrevocable grantor retained annuity trust (“GRAT”) for the primary benefit of spouse and two children. The trust had GST tax potential after the annuity term. The grantor retained an accountant to provide tax advice and to prepare any necessary tax returns for the GRAT. The accountant failed to advise the grantor of the automatic allocation rules for the GST exemption and the ability to opt out of the automatic allocation rules. While grantor timely filed the Form 709, the grantor failed to opt out of the automatic allocation of GST exemption.

Grantor requested an extension of time to elect out of the application of the automatic allocation of GST exemption to the GRAT. Treas. Reg. § 9100-3 permits extensions of time when the taxpayer shows that the taxpayer acted reasonably and in good faith and that grant of relief will not prejudice the interests of the government. A taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional and the tax professional failed to advise the taxpayer to make an election.

The IRS determined that these requirements were satisfied and granted the extension of time to opt out of the automatic allocation rules.

* 1. **Letter Ruling 202133007 (Issued April 2, 2021; Released August 20, 2021)**

**IRS grants extension of time to opt out of the automatic allocation rules for GST exemption**

Husband created four different grantor retained annuity trusts (GRATs). The gifts to each of the four GRATs were treated as made by both husband and wife. Each of the GRATs had GST tax potential period. Although an accountant and a lawyer worked with husband and wife on the GRATs, both the accountant and the lawyer failed to advise the taxpayers of the automatic allocation rules for the GST exemption and the ability to elect out of the automatic allocation rules. After discovering the failure to opt out of the automatic allocation rules, the husband and wife requested an extension of time to opt out.

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

The IRS determined that these requirements were satisfied and granted the extension of time to opt out of the automatic allocation rules.

* 1. **Letter Ruling 202116006 (Issued August 26, 2020; Released April 23, 2021)**

**Estate granted extension of time to allocate GST exemption to irrevocable exempt trusts for children**

Wife was survived by three children and three grandchildren. The value of the property in the Marital Trust and the Survivor’s Trust created at husband’s prior death exceeded the amount of the available GST exemption at wife’s death. As a result, separate exempt and non-exempt trusts were created to benefit each child and that child’s issue.

The trustees instructed an accounting firm to prepare the federal estate tax return for the wife’s estate, which was timely filed on extension. The accounting firm failed to prepare and include the Schedule R (Generation-Skipping Transfer Tax) with the federal estate tax return and the wife’s GST exemption was not affirmatively allocated to each child’s exempt trust. This error was discovered when the attorney for the estate requested a copy of and reviewed the federal estate tax return for the estate.

Wife’s estate requested an extension of time to allocate wife’s remaining GST exemption to the exempt trusts for the children.

Under Treas. Reg. § 301.9100-1(c), the IRS has the discretion to grant a reasonable extension of time. Treas. Reg. § 301.9100-3 provides that relief will be granted when the taxpayer acted reasonably and in good faith and that the grant of relief will not prejudice the interests of the government. A taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional to make the election. The IRS concluded that the requirements of Treas. Reg. § 301.9100-3 had been satisfied and granted the request for an extension of time to allocate wife’s GST exemption.

* 1. **Letter Ruling 202117001 (Issued July 14, 2020; Released April 30, 2021)**

**IRS grants extension of time to allocate GST exemption to family trust and exempt marital trust**

Decedent had an A/B Estate Plan which created a family trust and marital trust at his death. The marital trust was further divided into an exempt marital trust and non-exempt marital trust for GST tax purposes. The spouse of the decedent, in her capacity as executor, hired an attorney and accountant to help with the administration of the estate and to prepare and provide advice on all necessary tax returns. The executor was advised of the ability to allocate the decedent’s available GST exemption to the family trust and the exempt marital trust and intended to do so. However, the accountant inadvertently failed to file an application for the extension of time to file the federal estate tax return. The accountant discovered the error in preparing the decedent’s federal estate tax return and filed the return on a date prior to what would have been its extended due date had an extension been obtained.

The executor requested an extension of time to allocate decedent’s GST exemption to the family trust and the exempt marital trust.

The IRS granted the request for an extension pursuant to Section 2642(g) and Treas. Reg. § 301.9100-3. Section 2642(g) provides that in determining whether to grant relief, the IRS will take into account all relevant circumstances, including evidence of intent contained in the governing instrument and such other relevant factors.

Treas. Reg. § 9100-3 provides that relief will be granted when the taxpayer provides evidence to establish that the taxpayer acted reasonably and in good faith and that granting the relief will not prejudice the interests of the government. The taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional and the tax professional failed to make or failed to advise the taxpayer to make an election.

The Service determined that the requirements of Treas. Reg. § 9100-3 had been met and granted an extension of time.

* 1. **Letter Ruling 202133006 (Issued March 3, 2021; Released August 20, 2021)**

**IRS grants extension of time to allocate generation-skipping tax exemption to charitable remainder unitrust**

Prior to the enactment of the automatic allocation of GST exemption rules for indirect skips, Donor funded a charitable remainder unitrust (CRUT) which paid a unitrust amount for life to grandchild with the remainder to charity at grandchild’s death. Donor and spouse elected to split gifts and relied on an accounting firm to prepare separate Form 709s for the transfer to the CRUT. The accounting firm reported the value of the transfer to CRUT but did not allocate any part of either donor or spouse’s GST exemptions to the transfer to the CRUT. Donor subsequently died. The executor of donor’s estate and the spouse learned of the GST tax consequences when the Form 706 was prepared for the donor’s estate.

The executor and the spouse both requested an extension of time to allocate GST exemption to the transfer to the CRUT.

Treas. Reg. § 301.9100-3 permits an extension of time when a taxpayer shows that the taxpayer acted reasonably and in good faith and that the grant of the relief will not prejudice the interests of the government. A taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional and the tax professional failed to make or advise the taxpayer to make the election. The IRS determined that these requirements were satisfied and granted the extension of time to allocate GST exemption to the CRUT.

**FIDUCIARY INCOME TAX**

* 1. **T.D. 9918 (September 21, 2020)**

**IRS issues final regulations on effect of Section 67(g) on certain deductions for estates and nongrantor trusts under Section 67(e)**

In Notice 2018-61, 2018-31 IRB 278 (July 13, 2018), the Treasury Department and the IRS announced that they intended to issue regulations on the impact of new Section 67(g) of the Internal Revenue Code on certain deductions for estates and nongrantor trusts. Section 67(g) was added to the Code by the 2017 Tax Act and suspended temporarily miscellaneous itemized deductions for tax years beginning on or after January 1, 2018 through December 31, 2025. Proposed regulations on Section 67(g) were issued almost two years after the issuance of Notice 2018-61 on May 7, 2020. The final regulations adopted the proposed regulation with few changes.

The final regulations make clear that certain deductions for irrevocable nongrantor trusts and estate are still available. Administrative expenses such as trustee’s fees and appraisal fees can be deducted. Also certain expenses giving rise to excess deductions can be passed on to beneficiaries upon the termination of a trust or estate. While separating the deductions will require more work, this will allow beneficiaries to use some excess deductions on their income tax returns to reduce their adjusted gross income.

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

Tax practitioners expressed concern that Section 67(g) might inadvertently eliminate the deduction for costs of estate and trust administration. Practitioners also requested guidance on whether the suspension of miscellaneous itemized deductions prohibits trust and estate beneficiaries from deducting on their individual returns the excess deductions of the trust or estate incurred during the trust’s or estate’s final taxable year. The final regulations clarify that the costs of trust or estate administration are not miscellaneous itemized deductions suspended by Section 67(g).

The final regulations also address the impact of Section 67(g) on the ability of beneficiaries to deduct the excess deductions of an estate or trust upon the termination of the estate or trust. On the termination of a nongrantor trust or estate, Section 642(h) of the Code allows the beneficiaries succeeding to the property of the nongrantor trust or estate to deduct the trust’s or estate’s unused net operating loss carryovers under Section 172 of the Code and unused capital loss carryovers under Section 1212 of the Code. If an estate or nongrantor trust has deductions (other than deductions for personal exemptions or charitable contributions) in excess of gross income in its final taxable year, then Section 642(h) allows the beneficiaries succeeding to the property of the estate or trust to deduct such excess on their individual returns. Capital loss carryovers and net operating loss carryovers are taken into account in calculating adjusted gross income and are not miscellaneous itemized deductions. Section 67(g) therefore does not affect the ability of a beneficiary to make use of a capital loss carryover or net operating loss carryover received from an estate or nongrantor trust.

The excess deductions of an estate or nongrantor trust, however, are allowable only in computing taxable income and are not covered by an exception from miscellaneous itemized deductions in Section 67(b).

The final regulations preserve the tax character of the three categories of expenses rather that grouping all non-Section 67(e) expenses together, to allow for such expenses to be separately stated and to facilitate reporting it to beneficiaries. Each deduction comprising the Section 642(h)(2) excess deduction retains its separate character, specifically: as an amount allowed in arriving at adjusted gross income; a non-miscellaneous itemized deduction; or a miscellaneous itemized deduction. The final regulations also require fiduciaries to identify deductions that may be limited when claimed by a beneficiary.

The final regulations state that the principles under Treas. Reg. § 1.652(b)-3 will be used to allocate each deductible item among the classes of income in the year of termination in order to determine the character and amount of the excess deductions under Section 642(h)(2). Any remaining deductions that are not directly attributable to a specific class of income and any deductions that exceed the amount of directly attributable income, may be allocated to any item of income, but a portion must be allocated to tax-exempt income.

Existing regulations under Treas. Reg. § 1.642(h)-4 provide that carryovers and excess deductions to which Section 642(h) applies are allocated among the beneficiaries succeeding to the property of an estate or trust proportionately according to the share of each in the burden of the loss or deduction. A person who qualifies as a beneficiary succeeding to the property of an estate or trust with respect to one amount and who does not qualify with respect to another amount is a beneficiary succeeding to the property of the estate of the trust as to the amount with respect to which the beneficiary qualifies.

* 1. **Letter Ruling 202022002 (Issued February 25, 2020; Released May 29, 2020)**

**Third party treated as grantor of irrevocable trust**

Grantors created an irrevocable trust, which was designated as Trust 1, for the benefit of their children and grandchildren, and transferred otherwise unidentified Shares to the irrevocable trust. Then Trust 1 was divided into separate trusts for each of grantor’s children and grandchildren. The Trust 1 indenture prohibited the distribution of the Shares but allowed for the distribution of the proceeds from the sale of the Shares.

Subsequently, Trust 1 contributed all of its Shares to a limited liability company in exchange for membership interests in the limited liability company. The restrictions on the distribution of Shares also applied to the distribution of the LLC interests. Then, Trust 1 distributed a portion of its LLC interests to a Subtrust of which A was the sole beneficiary. The LLC’s assets included cash and the Shares. A could withdraw all of Subtrust’s assets, except the LLC interests, when A reached age 40. Subsequently, A withdrew all of the Subtrust’s assets except the LLC interests. Later, the trustees of the Subtrust agreed to sell a portion of the LLC interests held in the Subtrust to a new trust, Trust 2, in exchange for cash and a promissory note. Trust 2 was a grantor trust with respect to A. A also had the authority to withdraw the cash and the promissory note from the Subtrust after the proposed sale.

The IRS concluded that because A had the power exercisable by herself to vest the proceeds from the sale of the Subtrust’s LLC interests in herself and because those proceeds were the only assets of the Subtrust after the sale to Trust 2, A would be treated as the grantor of the Subtrust for fiduciary income tax purposes under Section 678. As a result, the transfer of the LLC interests to Trust 2 was not treated as a sale for federal income tax purposes because Trust 2 and the Subtrust were both treated as wholly owned by A for fiduciary income tax purposes.

**ASSET PROTECTION**

* 1. **Campbell v. Commissioner, T.C. Memo 2019-4**

**U.S. Tax Court respected a foreign asset protection trust and held that the IRS could not consider the trust assets in determining the taxpayer’s assets for purposes of collecting a tax liability**

In 2002 and while a resident of Connecticut, John F. Campbell filed his personal income tax return for 2001. Campbell’s return reported taxable income of just over $20,000 and a tax liability of about $60,000.

Near the end of 2002, Campbell and his family moved to the island of St. Thomas in the U.S. Virgin Islands. In 2004, while a resident of St. Thomas, Campbell created the First Aeolian Islands Trust pursuant to the law of Nevis, West Indies. Campbell named Meridian Trust Co. Ltd. as the initial trustee, although the trust protector, who held the power to remove and replace the trustee, later replaced Meridian Trust with Southpac Trust Nevis Ltd. The trust was structured as an irrevocable foreign asset protection trust. Campbell funded the trust with $5 million in cash and marketable securities.

At the time he created the trust, Campbell had a net worth of approximately $25 million. Campbell and members of his family could receive distributions from the trust in the sole discretion of the trustee, but Campbell never received any distributions of trust assets. Campbell could not appoint or remove the trustee nor direct the trustee to make any distributions or investments. The trust was a grantor trust as to Campbell for federal income tax purposes.

During 2001, Campbell had engaged in a tax shelter transaction (a custom adjustable-rate debt structure, or CARDS transaction). In 2004, the IRS initiated an examination of Campbell’s 2001 income tax return. In 2006, Campbell made a $27 million investment in the “GO-Zone” initiative in the U.S. Gulf Coast Region. Campbell’s investments consisted of commercial and residential real estate. In 2009, about half of the residential real estate was declared uninhabitable because it had been built using toxic drywall.

As a result of the drywall issues and the 2008 housing crash, Campbell’s investments generated an approximately $10.5 million net operating loss. Through a series of transactions in 2009, Antilles Offshore Investors Ltd., which was a subsidiary of Antilles Master Fund, a foreign entity the trust created, loaned money to one of Campbell’s business entities in the Gulf Coast Region. Because of personal guarantees on a number of other loans, Campbell effectively became insolvent by 2010.

In 2007, the IRS completed its examination of Campbell’s 2001 return and issued a notice of deficiency for approximately $13.9 million. Campbell filed a petition with the U.S. Tax Court contesting the deficiency. Campbell and the IRS ultimately settled and Campbell was able to deduct his net operating loss carryback against his 2001 deficiency. The settlement left Campbell with an approximately $1 million deficiency and a $100,000 accuracy-related penalty.

In 2010, the IRS issued a notice of intent to levy against Campbell’s assets, to which Campbell objected. In 2012, Campbell filed a petition with the Tax Court seeking to bar the levy. The Tax Court remanded the petition to the IRS Appeals Office.

At the Appeals Office hearings, Campbell submitted an offer in compromise on the basis of doubt of collectability and offered to settle all his outstanding debts for $12,603. The IRS stated that Campbell was ineligible for doubt of collectability status because he had “net realizable equity” of approximately $1.5 million in the trust. As negotiations collapsed, the IRS increased Campbell’s reasonable collection potential to more than $19.5 million by including the $5 million Campbell placed in the trust as dissipated assets. In 2018, the IRS formally rejected Campbell’s offer in compromise. Campbell appealed to the Tax Court.

The Tax Court reviews the IRS’ administrative determinations for abuse of discretion. Section 7122(a) of the Internal Revenue Code permits the IRS to compromise civil cases arising under the Internal Revenue Code. Regulations promulgated under Section 7122 list three grounds for compromise: (1) doubt as to liability, (2) doubt as to collectability and (3) promotion of effective tax administration.

Doubt as to collectability exists when the taxpayer’s income and assets are less than the amount of the tax liability. Doubt as to collectability is assessed on the basis of the taxpayer’s reasonable collection potential. A taxpayer’s reasonable collection potential is based on (1) assets, including dissipated assets; (2) future income; (3) assets collectible from third parties; and (4) assets available to the taxpayer but beyond the reach of the government.

Dissipated assets include assets that the taxpayer sold, transferred, encumbered or disposed of in an attempt to avoid the tax liability after the tax was assessed or for up to a period of six months before the assessment. According to the U.S. Supreme Court, assets collectible from third parties include assets that a third party is holding as a nominee or alter ego of the taxpayer.

The “nominee theory” focuses on whether the taxpayer is the true beneficial owner of the property. The “alter ego” theory focuses on whether the taxpayer has pierced the corporate veil. According to the Supreme Court, both theories look first at what rights the taxpayer has in the property under state law and then at federal tax law to determine whether the taxpayer’s rights constitute a property right for collectability purposes.

The Tax Court ultimately found that the IRS abused its discretion in considering the trust an asset for purposes of Campbell’s reasonable collection potential. The Tax Court held that the $5 million Campbell placed in the trust were not dissipated assets. Campbell placed the assets in the trust in 2002, three years before the IRS informed Campbell his 2001 return was under examination, six years before the assessment of the deficiency and 10 years before his offer in compromise. Accordingly, the transfer to the trust was beyond the permissible period for inclusion as a dissipated asset. Furthermore, even if the transfer to the trust took place within the permitted periods, Campbell had a net worth of over $25 million at the time he funded the trust.

The Tax Court also held that the trust was not considered an asset Campbell could collect from a third party. In making this finding, the Tax Court focused on two facts. First, Campbell had no control over the trustee and could not force the trustee to make distributions or investments. Second, Connecticut law, which governed Campbell’s state law rights in the trust at the time the tax deficiency arose in 2001, did not have a developed body of law as to whether Campbell had any property rights in a foreign asset protection trust. Because the IRS could not defend its position that Campbell had a property right in the trust under state law, the Tax Court held that the IRS’ position that the trust was available to Campbell was an abuse of discretion.

Finally, because Campbell did not have sufficient control over the trustee or the trust to compel a distribution or investment, the Tax Court held that the trust was not an asset of Campbell’s beyond the reach of the government. The Tax Court made this finding despite the IRS’ argument that Campbell had the de facto right to remove and replace the trustee through the trust protector and that the trustee loaned money to Campbell’s business at Campbell’s effective direction.

This case demonstrates that the Tax Court will respect a properly structured foreign asset protection trust. Most reported decisions involving asset protection trusts have held that the transfers to the trusts were fraudulent transfers or voluntary conveyances. Recently, however, cases with facts favorable to grantors have resulted in findings that respect asset protection trusts. In this case, the Tax Court respected a foreign asset protection trust when the trustee was fully independent of the grantor, the grantor could not remove or replace the trustee, the trustee had total discretion over distributions and investments, the grantor created the trust while the grantor was solvent, and the grantor had received no distributions from the trust.

**FIDUCIARY CASES**

* 1. **In re Jill Petrie St. Clair Trust Reformation, 311 Kan. 541, 464 P.3d 326, 2020 Kan. LEXIS 41, 2020 WL 3023373**

**The Supreme Court of Kansas reformed the terms of an irrevocable trust to conform to the settlor’s intent when intent proved by clear and convincing evidence**

In 2003, Jill Petrie St. Clair executed a trust agreement establishing her husband, William Paxson St. Claire, as a life beneficiary of the trust income. Upon William’s death, the trust income would then be distributed to Jill’s and William’s children and grandchildren, and the principal eventually would be distributed to the grandchildren. In 2002, before Jill created her trust, William established his own trust with an identical distribution scheme but naming Jill as a lifetime beneficiary of the trust’s income. Both Jill and William funded their trusts in identical amounts when Jill executed her trust agreement.

One of the purposes of William’s trust was to make sure the assets in his trust were not included in his or Jill’s taxable estates. M. Wayne Davidson, the attorney who prepared the trusts for Jill and William, proposed to Jill that she create her own trust to obtain gift tax benefits and to similarly assure that the assets in her trust were not included in William’s taxable estate. Jill’s trust agreement provided that “no part of this Trust shall be included in the Grantor’s gross estate for death tax purposes.” At the time Jill executed the trust agreement, she believed it contained the necessary provisions for the trust assets to be excluded from her and William’s taxable estates, and for the transfers to the trust to be considered completed gifts.

Because of a drafting error, Davidson failed to include two provisions in Jill’s trust to avoid the two trusts being considered reciprocal, resulting in the assets of Jill’s trusts being included in William’s estate and vice versa. Davidson omitted William’s ability to withdraw $5,000 or 5 percent of the trust assets. In addition, Davidson failed to give William a lifetime special power of appointment.

Because of the common distribution scheme, the trusts could be considered reciprocal. This was contrary to Jill’s intent.

Jill and the trustee petitioned the district court for an order reforming Jill’s trust, citing concerns that the trust as originally drafted would trigger the reciprocal trust doctrine and cause the assets in Jill’s trust to be included in William’s taxable estate upon his death. Jill and the trustee requested that the trust include the two provisions noted above.

The district court ordered that the trust be reformed to add the two new provisions to conform the trust with the grantor’s intent. To satisfy certain requirements under federal and Kansas law, Jill and the trustee appealed, and the Supreme Court of Kansas granted their motion to transfer the appeal from the Court of Appeals to the Supreme Court of Kansas.

“The court may reform the terms of a trust, even if unambiguous, to conform the terms to the settlor’s intention if it is proved by clear and convincing evidence that both the settlor’s intent and the terms of the trust were affected by a mistake of fact or law, whether in expression or inducement.” K.S.A. 58a-415.

In *In re Harris Testamentary Trust*, 275 Kan. at 957, the court approved the reformation of a testamentary trust under K.S.A. 58a-415 to shield the trust corpus from being included in the taxable estate of the settlor’s son, the trustee, when the facts showed (1) the settlor intended to exclude the trust assets from his own and his heirs’ estates, (2) the trust terms as drafted contained a mistake, and (3) the party seeking the reformation demonstrated a need under existing tax law for the proposed reforms.

The Supreme Court of Kansas stated that Jill and the trustee demonstrated by clear and convincing evidence that Jill’s intent in executing and funding the trust, and the terms of the trust itself, were both affected by a mistake of fact or law, making it necessary to reform the trust in order to conform to her true intent. The Supreme Court of Kansas added that absent reformation, the reciprocal trust doctrine would likely apply, which would destroy the economic symmetry of the two trusts.

The Supreme Court of Kansas held that reformation was necessary for the trust to be consistent with Jill’s original intent and to correct the scrivener’s error in excluding the two trust provisions. Accordingly, the district court did not err in reforming Jill’s trust.

* 1. **De Prins v. Michaeles, 154 N.E.3d 921, 486 Mass. 41, 2020 Mass. LEXIS 650, 2020 WL 6141080**

**The Massachusetts Supreme Judicial Court held that the assets of a self-settled spendthrift trust that allows distributions to the settlor during his lifetime, can be reached by the settlor’s creditors after the settlor’s death**

In 2000, Donald Belanger and his wife moved from Massachusetts to Arizona. In 2005, a dispute arose with their neighbors, Armand and Simonne De Prins, over shared water rights, which gave rise to litigation. In 2008, Belanger created an irrevocable trust that named himself as the sole beneficiary during his lifetime, Michael Michaeles as the sole trustee, and Belanger’s daughter as the beneficiary after Belanger’s death. In addition, the trust contained a spendthrift clause and provided that Belanger could not alter, amend, revoke or terminate the trust. Belanger conveyed substantially all of his assets to Michaeles as trustee of the trust.

Shortly thereafter, Belanger shot and killed the De Prinses. Belanger then shot and killed himself. Michaeles became personal representative of Belanger’s estate, which was probated in Arizona.

In 2010, the De Prinses’ son, Harry, brought a wrongful-death action against the personal representative of Belanger’s estate. That action was removed from Arizona state court to the U.S. District Court for the District of Arizona.

After learning about the trust, Harry brought a separate action in the U.S. District Court for the District of Arizona to reach and apply assets of the trust toward any judgment he may receive in the wrongful-death action. In 2015, Harry settled the wrongful-death action for $750,000. As part of the settlement, the parties stipulated that the wrongful-death judgment would be against the trust exclusively, through the reach-and-apply action, and the reach-and-apply action would be transferred to the U.S. District Court for the District of Massachusetts.

The District Court judge concluded that Harry satisfied the three elements required for a reach-and-apply action under Massachusetts common law. Moreover, the District Court concluded that a settlor may not use a self-settled spendthrift trust to protect his assets from creditors. The trustee appealed.

On appeal, because Massachusetts law did not clearly answer the question at hand, the First Circuit certified to the Supreme Judicial Court of Massachusetts the following question: “On the undisputed facts of this record, does a self-settled spendthrift irrevocable trust that is governed by Massachusetts law and allowed unlimited distributions to the settlor during his lifetime protect assets in the irrevocable trust from a reach and apply action by the settlor’s creditors after the settlor’s death?”

“The established policy of this Commonwealth long has been that a settlor cannot place property in trust for his own benefit and keep it beyond the reach of creditors.” *Ware v. Gulda*, 331 Mass. 68, 70, 117 N.E.2d 137 (1954), quoting *Merchants Nat’l Bank of New Bedford v. Morrissey*, 329 Mass. 601, 605, 109 N.E.2d 821 (1953). The prohibition against using a self-settled trust to protect one’s assets against creditors applies both to current and future creditors. *Forbes v. Snow*, 245 Mass. 85, 89, 140 N.E. 418 (1923).

The Massachusetts Supreme Judicial Court answered the certified question in favor of Harry by stating, “The well-established legal maxim that one must be just before being generous compels us to conclude that it does not.” See *Foster v. Hurley*, 444 Mass. 157, 172, 826 N.E.2d 719 (2005) (Greaney, J., dissenting in part); *Hill v. Treasurer & Receiver Gen., 229 Mass*. 474, 477, 118 N.E. 891 (1918); *Chase v. Redding*, 79 Mass. 418, 13 Gray 418, 420 (1859).

The Massachusetts Supreme Judicial Court recognized that the answer to the certified question hinged on whether the common law or the Massachusetts Uniform Trust Code applied. After reviewing the MUTC, the Massachusetts Supreme Judicial Court determined that the MUTC is supplemented by the common law of trusts and principles of equity. Furthermore, the Massachusetts Supreme Judicial Court determined that because the MUTC did not directly address the present case, the common law applied.

The Massachusetts Supreme Judicial Court concluded that the facts here lean toward the creditor because the judgment at issue accrued before Belanger’s death, and it is well-established in Massachusetts that a settlor may not use a self-settled trust to protect his assets from creditors.

In addition, the Massachusetts Supreme Judicial Court explained that it would be unequal for a self-settled trust not to protect a settlor’s assets from creditors while the settlor is alive but to have it protect the settlor’s beneficiaries from the settlor’s creditors after the settlor’s death. Accordingly, the Massachusetts Supreme Judicial Court held that a self-settled trust does not become protected from the settlor’s creditors upon the settlor’s death.

The trustee argued that because Belanger did not receive assets during his lifetime, he was not able to “have his cake and eat it too.” However, the Massachusetts Supreme Judicial Court responded by explaining that the important point is what is within the trustee’s power, not what the trustee actually does. *Tilcon Capaldi*, Inc., 249 F.3d at 60.

Finally, the Massachusetts Supreme Judicial Court concluded that the equities simply do not allow Belanger to murder Harry’s parents and then leave Harry with no recovery in a subsequent wrongful-death action, despite Belanger possessing substantial assets.

The Supreme Court of Massachusetts answered the certified question by holding that a self-settled spendthrift irrevocable trust that is governed by Massachusetts law and that allowed unlimited distributions to the settlor during his lifetime does not protect assets in the irrevocable trust from a reach-and-apply action by the settlor’s creditors after the settlor’s death.

* 1. **Wilburn v. Mangano, 851 S. E.2d 474 (Va. 2020)**

**The Virginia Supreme Court found that the term “fair market value” on a specific date in a codicil, without more, failed to provide sufficient certainty as to the purchase price to warrant specific performance of an option contract for sale**

On March 19, 2002, Jeanne Mangano executed a will wherein she left her residence to her three daughters, Ann, Mary and Carol, and granted her son, Anthony, an option to purchase the property from his sisters. Under the terms of the will, Anthony could exercise the option within one year from the probate of Jeanne’s will at a price equal to the property’s real estate tax assessment in the year of her death. On Oct. 12, 2005, Jeanne executed a codicil that revised the purchase price “to an amount equal to the fair market value at the time of Jeanne’s death.” Jeanne died Nov. 16, 2005.

Shortly thereafter, Anthony sent a letter to his sisters “to serve as legal notice of his intent to exercise the option to purchase” under the terms of the will or the codicil, whichever was found to be valid. Anthony also filed suit to set aside the codicil, which a jury determined to be valid.

The sisters then filed suit to compel Anthony to purchase the property in accordance with his exercise of the option. The sisters alleged they had obtained two appraisals of the fair market value of the property as of Jeanne’s death — one valuing the property at $311,000, and the other at $270,000. They requested that Anthony be compelled to specifically perform.

Anthony filed a demurrer. He contended that there was no enforceable contract because “an amount equal to the fair market value at the time of Jeanne’s death” is not a sufficiently specific term to establish mutual assent as to the purchase price of the property. The trial court sustained Anthony’s demurrer, and entered an order dismissing the case with prejudice. The trial court held that there was no enforceable contract because “the will, codicil, and notice of acceptance did not determine the purchase price and did not provide a method of determining the purchase price.”

The sisters appealed.

Price is a material term of a contract and it must be specified in the agreement itself, or the agreement must provide a mode for ascertaining it with certainty before a court will compel specific performance. *Moorman v. Blackstock, Inc.*, 276 Va. 64, 75 (2008).

The term “fair market value” generally means the price a seller is willing to accept and a buyer is willing to pay on the open market and in an arm’s-length transaction.

The Virginia Supreme Court held “fair market value” on a specific date, without more specificity, is not a sufficiently certain price term to allow a court to compel specific performance of a contract regarding the purchase of real estate and upheld the trial court’s decision.

In considering specifically whether “fair market value” in these circumstances is sufficiently specific to set the purchase price, the court relied on the fact that “[t]here is no single fixed approach to determine fair market value, as applied by appraisers or Virginia courts.” Rather, Virginia courts recognize a variety of approaches, including without limitation, the cost approach, the income approach, the sales approach and the comparable sales approach. Given the multitude of valuation approaches, the court found that without additional specification, the term “fair market value” on a specific date failed to provide a mode for ascertaining the price with sufficient certainty to allow the court to compel specific performance on the option.

* 1. **Neal v. Neal, 2020 Tex. App. LEXIS 4514, 2020 WL 3263433**

**A Texas appeals court upheld a final judgment construing a trust when the trust was later challenged**

Brucilla Neal created a revocable trust in 1991. Under the terms of the trust, upon Brucilla’s death, the trust assets would go in certain percentages to her daughter, Karen, to her son, George, and to her nephew, Homer. The trust also provided that under no circumstances would George receive any assets from the trust if he had a relationship with Pamela Faulkner.

In 2007, Brucilla amended her trust to provide that instead of Karen and George receiving the trust assets outright, the assets would be placed in separate trusts for their benefit. In addition, the amendment provided that Karen and George, at each of their deaths, could each devise by will how to distribute any remaining trust assets to their descendants; otherwise, the assets would go to their respective descendants.

In 2008, Brucilla amended her trust again to provide that if George predeceased her or had a relationship with Pamela Faulkner, his share of the trust assets would go to Karen during her lifetime and then to Karen’s descendants. In addition, the 2008 amendment provided that at George’s death, the remaining assets of George’s trust would go to Karen or Karen’s descendants. Thus, pursuant to the 2008 amendment, George no longer had the ability to devise by will his share of the trust assets to his descendants and his descendants no longer held remainder interests in the trust.

Brucilla died in January 2009; Karen died later that year. Homer served as trustee of George’s trust. A dispute arose between George and Homer regarding distributions. Homer filed a declaratory judgment action to determine his obligations as trustee. George counterclaimed seeking to invalidate the 2008 amendment. The trial court joined Karen’s children, George Whisler and Melanie Pugh.

The parties mediated the conflict and later entered into a settlement agreement, and the trial court entered a final judgment in 2012. The trial court judgment, consistent with the settlement agreement, modified Brucilla’s trust to remove all provisions regarding Pamela Faulkner. However, the judgment retained the language stating that upon George’s death, the assets are distributed to Karen or to her living descendants. The final judgment also stated that, given Karen’s death, “George Whisler and Melanie Pugh are the only children of Karen S. Pugh, and are the only remainder beneficiaries of the George’s Trust.”

George died in 2017. His widow and estate administrator sought to obtain funds from his trust. The trustee informed the estate administrator that he intended to distribute the assets to Karen’s descendants. Afterward, the estate administrator filed a declaratory judgment. The trial court entered a judgment confirming George Whisler and Melanie Pugh as the only remainder beneficiaries of the trust. The estate administrator appealed.

The court interprets an agreed judgment like a contract between the parties, seeking to harmonize and give effect to all its provisions so none are rendered meaningless. See Mann v. Propst, No. 05-19-00432-CV, 2020 Tex. App. LEXIS 2581, 2020 WL 1472212, at \*6 (Tex. App.—Dallas Mar. 26, 2020, no pet.) (mem. op.).

On appeal, George’s estate argued that the agreed judgment made George Whisler’s and Melanie Pugh’s remainder interests contingent on George either predeceasing Brucilla or having a relationship with Pamela Faulkner, and because neither occurred, George Whisler’s and Melanie Pugh’s interests were divested. The Court of Appeals disagreed with George’s estate. The Court of Appeals found that George’s estate ignored the 2012 settlement agreement, which clearly stated that George Whisler and Melanie Pugh are the only remainder beneficiaries of George’s trust. Accordingly, the Court of Appeals confirmed the judgment of the trial court.

* 1. **Ron v. Ron, 2020 WL 6494223 (5th Cir. 2020)**

**The 5th U.S. Circuit Court of Appeals affirmed the U.S. District Court, Southern District of Texas, decision that a trust protector has no fiduciary duty to the settlor**

A wife created a trust with her children as beneficiaries and naming her husband as trustee and a friend as the trust protector. The trust agreement provided that the trust protector’s purpose is “to direct the trustee in certain matters concerning the trust, and to assist, if needed, in achieving [the wife’s] objectives expressed by other provisions of [the wife’s] estate plan hereunder.” The trust agreement also permitted the trust protector to add, among others, the husband, as a beneficiary of the trust. The trust agreement stated that the trust protector’s authority was conferred “in a fiduciary capacity.”

Husband and wife later separated. The wife filed suit against the trustee and the trust protector alleging that: (1) the husband made inappropriate transfers of community property to the trust both before and after the couple’s divorce, and (2) the trust protector wrongfully added the husband as a trust beneficiary. The trustee and the trust protector filed motions to dismiss, which were granted by the U.S. District Court, Southern District of Texas.

The wife appealed.

Texas law recognizes two types of fiduciary relationships: formal fiduciary relationships and informal fiduciary relationships. A formal fiduciary relationship is expressly created by law or the terms of an agreement, such as an attorney’s fiduciary duties to a client. By contrast, an informal fiduciary relationship arises from a special relationship of trust and confidence. The special relationship must exist prior to and apart from the transaction in question.

The 5th U.S. Circuit Court of Appeals agreed that the trust protector owed no duty to the wife, as the settlor.

First, no formal fiduciary relationship existed between the wife and the trust protector. Under the Texas statute governing trust protectors, the trust protector’s fiduciary duties were owed to the trustee, and not the settlor. Furthermore, the trust agreement stated that the wife had no interest or incidence of ownership in the trust. Accordingly, the wife could not compel the trust protector to take an action and the trust protector owed the wife no duties under the trust agreement.

Second, no informal relationship existed between the wife and the trust protector where the only evidence of a “special relationship” between the two was the wife’s appointment of him as trust protector.

For a more in depth analysis please see “[Recent Cases of Interest to Fiduciaries: September 2020](https://media.mcguirewoods.com/publications/2020/Recent-Cases-Interest-Fiduciaries-Sept-2020.pdf).”

* 1. **Platt v. Griffith, 853 S.E.2d 63 (Va. 2021)**

**The Virginia Supreme Court held that the personal representative of an estate is the only party entitled to bring suit on behalf of the estate for personal claims that would belong to the decedent during the decedent’s lifetime**

In 2008, Dr. Lloyd Griffith executed a will leaving his residuary estate, including 704-acre Albany Farm, in a lifetime trust for the benefit of his second wife, Mary Cate. If Mary Cate predeceased Dr. Griffith, Albany Farm would pass to Dr. Griffith’s son, Charles, apart from two 10-acre parcels, one for each of Dr. Griffith’s two daughters, Mary and Lindsay.

In 2010, Dr. Griffith executed a new will, revoking and replacing all prior wills. The 2010 will left a 20-acre parcel of Albany Farm to each of Mary and Lindsay. Dr. Griffith left the remainder of his property, including the remaining 664 acres of Albany Farm, to Charles and Mary Cate.

In 2016, Dr. Griffith executed a deed of gift giving the entire 704-acres of Albany Farm to Charles and Mary Cate. Mary Cate received a life estate and the remainder went to Charles. The 2016 deed was silent as to the two 20-acre parcels Dr. Griffith's 2010 will left to Mary and Lindsay.

Dr. Griffith died six months following the 2016 deed of gift. He was survived by Mary Cate, Charles, Mary and Lindsay. Initially, Dr. Griffith’s 2008 will was probated. However, Charles, in his capacity as personal representative of the estate, later filed a suit requesting to probate the 2010 will. Mary and Lindsay unsuccessfully challenged the validity of the 2010 will, and they did not appeal the trial court decision.

In 2018, the daughters sued Mary Cate and Charles individually, alleging that they conspired to convert $13 million of Dr. Griffith's assets and used their confidential relationship with Dr. Griffith to unduly influence him into signing the 2014 chattel deed and the 2016 deed of gift. Accordingly, the daughters sought a declaration that both were void.

Mary Cate and Charles individually moved to dismiss the daughters’ complaint for lack of standing.

The circuit court dismissed the complaint with prejudice, noting that the transfers at issue occurred during Dr. Griffith's lifetime. Accordingly, the circuit court concluded that only Dr. Griffith's personal representative could bring the claims. The court specifically held that the daughters did not have "any right, title or interest" to the property at issue, as the 2016 deed of gift extinguished the prior testamentary gifts of the two 20-acre parcels on Albany Farm.

Mary and Lindsay appealed, arguing that they are “vested beneficiaries” of two 20-acre parcels of Albany Farms, and thus have standing to pursue the rescission of the 2016 *inter vivos* deed of gift.

To establish standing, a litigant must "show an immediate, pecuniary, and substantial interest in the litigation, and not a remote or indirect interest." *Westlake Props., Inc. v. Westlake Pointe Prop. Owners Ass'n., Inc.*, 273 Va. 107, 120, 639 S.E.2d 257 (Va. 2007). Under Virginia law, the proper party to litigate on behalf of the estate is the personal representative, not a beneficiary of the estate, even when the personal representative is also a possible beneficiary. *Reineck v. Lemen*, 292 Va. 710, 722, 792 S.E.2d 269 (Va. 2016); *see also* Va. Code § 1-234.

A specific bequest is revoked if the testator disposes of the property prior to death. See *May v. Sherrard,* 115 Va. 617, 623, 79 S.E. 1026 (1913); *King v. Sheffey*, 35 Va. (8 Leigh) 614, 619 (1837). This is called “ademption by extinction.”

The Virginia Supreme Court held that the daughters lacked standing to seek the rescission of the *inter vivos* 2016 deed of gift. As potential beneficiaries under the 2010 will, the daughters’ claims only indirectly benefit them. Rather, the entity that “directly benefits” is Dr. Griffith’s estate. Moreover, the rescission claim would have belonged to Dr. Griffith during his lifetime, and consequently, such claim is inherently on behalf of the estate. Accordingly, the proper party to litigate claims related to the 2016 gift is the personal representative of Dr. Griffith’s estate, not the daughters.

The daughters argued that it was unreasonable to expect Charles, as personal representative, to pursue these claims on behalf of the estate. The misconduct directly benefits Charles and he is the perpetrator. The Virginia Supreme Court dismissed such concerns where the daughters had failed to file a petition to remove and replace Charles as personal representative of the estate.

The Virginia Supreme Court affirmed the circuit court’s decision and held that Charles, as personal representative, was the only one who had standing to seek rescission of the 2016 deed of gift.

In a footnote, the court also noted that the daughters were not “vested beneficiaries” of the two 20-acre parcels of Albany Farms under the 2010 will. The two parcels were conveyed by the 2016 deed of gift. As a result they were not part of Dr. Griffith’s estate, and the daughters’ interests never vested.

* 1. **In re Matter of the Ruff Management Trust, 2020 WL 7065829 (Tex. Ct. App. Dec. 3, 2020)**

**A Texas Court of Appeals held that a trial court’s order modifying the trustee removal provisions of a trust agreement was not subject to review on appeal because the modification was consistent with the material purposes of the trust and caused no harm to the interested parties**

Suzann Ruff and her son Mike created the Ruff management trust in 2007, with Suzann as the primary beneficiary and her five children as remainder beneficiaries. Following the resignation of Mike and then Frost Bank as trustees, Suzann’s three children Tracy, Mark and Kelly (the “three children”) became co-trustees, in accordance with the terms of the trust. In 2019, Suzann filed a motion to modify the trust, which the trial court denied, and subsequently filed another motion to modify or terminate the trust, or alternatively, to appoint a new trustee. Specifically, the motion requested modification to eliminate the requirement that Suzann act jointly with Mike to appoint a successor trustee and instead allow her to appoint a trustee on her own. The three children opposed the second motion. After hearing evidence and the parties’ positions, the judge signed an order modifying the trust. The three children appealed, arguing that the trial court’s trust modification was an abuse of discretion and reversible error because: (i) the evidence was legally insufficient to support the modification and the modification was contrary to the trust’s purpose, and (ii) the order was signed without affording them a jury trial.

On petition of a trustee or beneficiary, a court may order that the trustee be changed, that the terms of the trust be modified, that the trustee be directed or permitted to do acts that are not authorized or that are forbidden by the terms of the trust, that the trustee be prohibited from performing acts required by the terms of the trust, or that the trust be terminated in whole or in part if: (1) the purposes of the trust have been fulfilled or have become illegal or impossible to fulfill; (2) because of circumstances not known to or anticipated by the settlor, the order will further the purposes of the trust; (3) modification of administrative, non-dispositive terms of the trust is necessary or appropriate to prevent waste or impairment of the trust’s administration; (4) the order is necessary or appropriate to achieve the settlor’s tax objectives or to qualify a distributee for governmental benefits and is not contrary to the settlor’s intentions; or (5)(a) continuance of the trust is not necessary to achieve any material purpose of the trust, or (b) the order is not consistent with a material purpose of the trust.

On appeal, the Court of Appeals held that the modification caused no harm to the appellants, and therefore, a determination of the sufficiency of the evidence was irrelevant. A trust modification is within the trial court’s discretion. More specifically, because of conflict between Suzann and Mike, including arbitration wherein Mike was found to have committed fraud with respect to the trust, the trial court’s order recognized Suzann’s right to seek court approval to replace or remove a trustee. The order did not remove the three children as trustees, and therefore the three children did not suffer any actual harm as a result of the modification.

The Court of Appeals further held that the modification was not inconsistent with the trust’s purpose. The trust agreement directs the trustees to make distributions of income and principal to the settlor (Suzann) for health, support, maintenance, education and best interests. The modification does not appoint Suzann as trustee, or affect how the trustees make distributions. It simply changed the third party involved in the decision to remove and replace a trustee.

Lastly, the Court of Appeals held that the three children were not deprived of their right to a jury trial because they failed to timely object to proceeding before the trial court. Although the three children filed two jury demands before the hearing, the three children failed to object on the record when the trial court proceeded without a jury or otherwise affirmatively indicate that they intended to stand on their perfected jury trial right, and continued to participate in the modification hearing. Thus, the issue was not preserved for review by the Court of Appeals.

* 1. **Hodges v. Johnson, 2020 WL 5648573 (May 13, 2020)**

**The Supreme Court of New Hampshire held that trustees were not entitled to reimbursement or indemnification for fees incurred in defending improper decantings where the trustees were found to have been in serious breach of fiduciary duties**

David Hodges created two irrevocable trusts to hold stock in a family business, with William Saturley and Alan Johnson (the “former co-trustees”) as trustees. The trusts ultimately created separate trusts for the benefit of the Hodges children and stepchildren. Hodges hired attorney McDonald in 2009 to assist with estate planning, and stated he wanted to revoke the provisions benefiting his stepchildren. McDonald advised that the trusts could be decanted to new trusts, of which the stepchildren would not be beneficiaries. Over a few years, McDonald decanted the trusts three times.

First, in 2010, Johnson resigned as trustee in favor of McDonald. McDonald decanted both trusts, removing the stepchildren as beneficiaries. Johnson was reappointed as trustee and McDonald resigned. Second, in 2012, McDonald was appointed as trustee and decanted the trusts to exclude Hodges’ biological son, David Jr. Again, to accomplish this, Johnson resigned as trustee in favor of McDonald. McDonald decanted both trusts, Johnson was reappointed as trustee, and McDonald resigned. Lastly, in 2013, McDonald was appointed as trustee and decanted the trusts to exclude Hodges’ wife, Joanne. After decanting, McDonald resigned as trustee and Johnson was reappointed as trustee.

In 2014, David Jr. and the stepchildren filed a petition to invalidate the decantings and to remove Johnson and Saturley as trustees. The Circuit Court ruled in favor of the beneficiaries. Johnson, Saturley and McDonald appealed. On appeal, the Supreme Court of New Hampshire affirmed the trial court’s order declaring the decantings void *ab initio* and removing Saturley and Johnson as trustees. After the case was returned to the trial court, the trial court appointed Judith Bomster and J. Daniel Marr as successor co-trustees of the trusts.

The former co-trustees filed a motion for fees and costs they personally incurred while defending the decantings. The successor co-trustees objected and filed a motion asking the court to order the former co-trustees to repay the trusts for fees and costs incurred on behalf of the former co-trustees to defend the decantings. The trial court denied the former co-trustees’ motion, granted the successor co-trustees’ motion and ordered the former co-trustees to reimburse the trusts. The former co-trustees appealed.

A trustee is entitled to be reimbursed out of the trust property, with interest as appropriate, for expenses that were properly incurred in the administration of the trust. R.S.A. § 564-B:7-709(a)(1). The official comments to the Uniform Trust Code provide that “reimbursement under this section may include attorney’s fees and expenses incurred by the trustee in defending an action. However, a trustee is not ordinarily entitled to attorney’s fees and expenses if it is determined that the trustee breached the trust.”

In administering, investing and managing the trust and distributing the trust property, the trustee may incur only costs that are reasonable in relation to the trust property, the purposes of the trust and the skills of the trustee. R.S.A. § 564-B:8-805.

The Supreme Court of New Hampshire affirmed the trial court’s order, holding that (1) fees and costs incurred by the former co-trustees to defend improper decantings were not “properly incurred” in connection with their duties to administer the trusts; (2) the former co-trustees were not entitled to statutory indemnification for “reasonable” costs incurred in defending the decantings; and (3) the court could require the former co-trustees to personally reimburse the trusts for attorney’s fees and costs incurred in defending the former co-trustees’ improper decantings.

The trial court ruled that the former co-trustees were not entitled to reimbursement because the fees and costs incurred to defend the decantings were not “properly incurred” as part of their duties to administer the trusts. The former co-trustees were found to have committed a serious breach of trust. In affirming the trial court’s findings, the Supreme Court noted that the former co-trustees had no fiduciary duty to defend their misconduct. The conflict between the interests of the beneficiaries was created by the decanting; thus, the former co-trustees were not entitled to reimbursement for expenses related thereto. The former co-trustees failed to obtain independent legal advice or petition a court for instruction as to the proposed decantings, and instead proceeded based solely on the advice of the settlor’s counsel.

The Supreme Court agreed with the trial court that the circumstances of the decantings should have caused the former co-trustees to have reasonable doubt as to whether the decantings were proper, and that the trial court did not err in suggesting that the former co-trustees could have filed a petition for instruction or obtained an independent legal opinion, instead of relying on McDonald’s advice. Accordingly, the trial court did not err in ruling that the former co-trustees were not entitled to reimbursement for the fees and costs personally incurred to defend the decantings.

The Supreme Court further agreed with the trial court with respect to the former co-trustees’ request for indemnification for reasonable costs. The trial court ruled that the former co-trustees were not entitled to indemnification because of their “serious and egregious breaches,” and the Supreme Court found such ruling to be supported by the evidence and not contrary to law. The trial court ruled that the former co-trustees breached their duty of impartiality, and as such breach could reasonably be deemed “serious,” the Supreme Court found no error in the trial court’s determination on indemnification.

Lastly, the Supreme Court affirmed the trial court’s award of attorney’s fees to the successor co-trustees, noting that the trial court determined that, because of the former co-trustees’ serious breach, improper reliance on the settlor’s counsel (McDonald), failure to seek independent legal advice or court guidance concerning their duties, and pursuit of the decantings that increased the likelihood of litigation, it would be unfair and unjust to charge the trusts with the costs of litigation in defense of a breach of fiduciary duty.

* 1. **Turk v. Morris, Manning & Martin, LLP, Case 1:20-mi-99999-UNA (N.D. Ga. 2020)**

**Class action plaintiffs alleged that law firm and other defendants promoted and advised on prepackaged conservation easements that did not qualify for the charitable deduction from federal income tax**

William Turk and other plaintiffs sued law firm Morris, Manning & Martin, LLP, and other defendants in the Northern District of Georgia alleging that the defendants induced Turk and the other plaintiffs to participate in a conservation easement deduction strategy called the Syndicated Conservation Easement Strategy (SCE strategy).

Turk alleged that the SCE strategy used a complex web of partnerships to convey real estate interests to a charity after fraudulently inflating the value of the donated interests. Turk further alleged that the defendants sold the scheme to him and other clients to obtain the corresponding tax deduction.

In particular, Turk alleged that the defendants sold “prepackaged” appraisals that vastly overstated the fair market value of the interest being donated to charity, which in turn overstated the charitable deduction the donor (such as himself) could receive. Turk alleged that the defendants knew or should have known that the transactions did not meet the requirements to qualify for a conservation easement deduction. Turk also alleged that promotional materials sent to prospective clients indicated a donor could receive $2 in tax savings for every $1 invested.

Turk also alleged that, without informing him or the other plaintiffs, the defendants entered into improper agreements with each other that eliminated their independence and furthered the defendants’ best interests over the interests of the plaintiffs, who were their clients.

Turk alleged breaches of fiduciary duty, racketeering, fraud, negligent misrepresentation and other claims, and requested ordinary and punitive damages as well as disgorgement of fees.

Taxpayers can claim a charitable deduction for granting conservation easements on real estate. However, the easement must meet several strict requirements under the Internal Revenue Code and Treasury Regulations. The IRS has listed syndicated conservation easement transactions as potentially abusive in that they may exploit the deduction by obtaining appraisals that inflate the value of the property and accordingly the tax deduction to the donor.

The District Court has not yet ruled on the defendants’ motion to dismiss.

* 1. **Burgess v. Johnson, 835 Fed. Appx. 330, 2020 WL 6479178 (Nov. 4, 2020)**

**The 10th U.S. Circuit Court of Appeals held that a trustee’s power under the trust agreement to submit a claim against the trust or the trustee to arbitration did not allow the trustee to compel arbitration of a beneficiary’s claim for breach of trust**

Howard Johnson served as sole trustee of a trust created under Oklahoma law. In May 2019, the beneficiaries of the trust sued Johnson in federal court alleging he breached his fiduciary duties by wrongfully taking trust assets.

Johnson moved to compel arbitration of the beneficiaries’ claim. He cited a provision of the trust agreement that authorized him “[t]o compromise, contest, submit to arbitration or settle all claims by or against, and all obligations of, the Trust estate or the Trustees” (the arbitration provision). Johnson further pointed out that the trust agreement allowed him to exercise this authority “in [his] sole discretion.”

The District Court for the Northern District of Oklahoma denied Johnson’s motion to compel arbitration. Johnson appealed to the 10th U.S. Circuit Court of Appeals.

A court will apply contract law principles to analyze an agreement to arbitrate claims. In construing the terms of a contract, the document’s plain language governs its interpretation.

The 10th Circuit affirmed the District Court’s denial of Johnson’s motion to compel arbitration. The court found that the arbitration provision simply granted the trustee a range of options to resolve disputes, which also included the power to compromise and settle claims. The trust agreement did not empower Johnson to *compel* *others* to arbitrate claims.

In reviewing the arbitration provision, the court noted that the provision applied to beneficiaries’ claims as well as claims involving third parties who had no interest in the trust. The arbitration provision clearly did not (and could not) allow the trustee to compel a third party to submit to arbitration. Therefore, the court found it unlikely the grantor had intended the arbitration provision to require the beneficiaries to arbitrate claims against the trustee.

* 1. **Bergal v. Bergal, 153 N.E.3d 243 (Ind. Ct. App. Sept. 17, 2020)**

**The dead man’s statute may apply to prevent a party whose interest is adverse to the estate from testifying about matters against the estate in certain trust cases where the trust at issue is so central to the overall estate plan that it is akin to the estate itself**

The decedent, Dr. Milton Bergal, created an estate plan consisting of a will and trust. His son and wife were the two primary beneficiaries of the trust. The will that was created at the same time as the trust was a “pour over will which said that if [the decedent] owned anything in his name it would pour over into the trust so that everything would be in the trust at the time of his death.”

The decedent became ill with dementia and Alzheimer’s disease and later died. While he was ill, his wife moved assets out of the trust and named herself the primary beneficiary of those assets. This change effectively resulted in disinheriting the son. After the decedent’s death, his son filed a complaint seeking return of the moved assets to the trust.

A trial jury unanimously found in favor of the son. Each of the assets was ordered to be restored to the trust. Before the trial began, the son had filed a motion in limine seeking to prohibit the wife from testifying about statements made by the decedent pursuant to the dead man's statute. Ind. Code ch. 34-45-2. The trial court granted the motion, holding that the wife "may not testify about what Dr. Bergal said or testify about actions that constitute an assertion by Dr. Bergal." (p. 249).

On appeal, the wife argued that this order was erroneous primarily because the dead man’s statute does not apply to cases involving trusts because trusts are distinct from estates. Secondarily, the wife argued that the dead man’s statute does not apply because there was no executor or administrator who was a party to the litigation.

The dead man’s statute, Indiana Code § 34-45-2-4, may apply in certain trust cases where “the trust at issue is so central to the overall estate plan that it is akin to the estate itself.” (p. 256).

The general purpose of the dead man's statute is to protect a decedent's estate from spurious claims. It is a rule of fairness and mutuality requiring that, when the lips of one party to a transaction are closed by death, the lips of the surviving party are closed by law. Rather than excluding evidence, the statute prevents a particular class of witnesses from testifying about claims against the estate. The statute does not render the surviving party incompetent for all purposes; instead, its application is limited to circumstances in which the decedent, if alive, could have refuted the testimony of the surviving party. (p. 254).

“Even if an administrator or executor is not a party to the action, the Dead Man’s Statute applies where one of the parties is acting in the capacity of an administrator or executor.” (p. 254, FN 10).

In a trust dispute, the trial court correctly found that the dead man’s statute (Indiana Code § 34-45-2-4) prevented testimony from a party adverse to the estate about her deceased husband’s statements because the trust at issue was “so central to the overall estate plan that it was akin to the estate itself.” (p. 256). In this case, the will created at the same time as the trust was a pour-over will, which said that if the decedent owned anything in his name it would pour over into the trust so everything would be in the trust at the time of his death; therefore, the trust was the primary piece of the overall estate plan.

Secondarily, the appellate court noted that the dead man’s statute applies where one of the parties is acting in the capacity of an administrator or executor. In this case, the appellate court held that one of the parties to the litigation was the trustee of the trust at issue so he was acting in the capacity of an administrator or executor.

* 1. **In Re Passarelli Family Trust, J-46-2020 (Supreme Court of Pennsylvania December 22, 2020); see also In Re Passarelli Family Trust, 231 A.3d 969 (Superior Court of Pennsylvania April 16, 2020)**

**A settlor alleging fraudulent inducement in the creation of an irrevocable trust must prove the elements of common law fraud by clear and convincing evidence**

A husband and wife established an irrevocable trust after 20 years of marriage to keep their marital assets in the family and ensure they are passed on to their minor children. The trust included multiple real estate properties held by two real estate property companies. The husband owned 100 percent of the real estate companies. Unbeknownst to the wife, the real estate companies’ assets included two properties in Florida. When presented with the trust inventory of assets, which included the real estate companies, the wife did not question its contents. She was not presented with a listing of the specific holdings of the real estate companies, e.g., the Florida properties.

Four months after creation of the trust, the wife discovered that the husband was having an affair and his paramour was living in one of the Florida properties. The wife filed for divorce and then filed an emergency petition for special relief to prevent dissipation of the marital assets, including assets in the trust — a “Petition for Citation to Terminate Irrevocable Trust” in the ophans’ court. The wife argued that the trust was void *ab initio* based on a theory of fraudulent inducement at the time the trust was created. She argued that the husband fraudulently induced her to create the trust by not disclosing the Florida properties and she would not have agreed to a trust that included properties where his paramour resided. Her fraud claim was specifically based on her husband’s failure “to disclose all of the marital assets.”

The Supreme Court Pennsylvania adopted the elements of common law fraud as the standard for determining fraud in the inducement of an irrevocable trust.

A settlor seeking to void an irrevocable trust based on a theory of fraudulent inducement pursuant to 20 Pa.C.S. § 7736 bears the burden of proving the common law elements of fraud by clear and convincing evidence. This aligns with the Uniform Law Comment to 20 Pa.C.S. § 7736 the authority cited therein and general principles of Pennsylvania law.

At common law, “fraud is practiced when deception of another to his damage is brought about by a misrepresentation of fact or by silence when good faith required expression*.” In re Thome’s Estate*, 25 A.2d 811, 816 (Pa. 1942).

“Pennsylvania trust law does not require that trust property be identified or described in any particular manner or to any particular level of detail. Indeed, ‘[a] declaration of trust can be funded merely by attaching a schedule listing the assets that are to be subject to the trust without executing separate instruments of transfer.’ 20 Pa.C.S. § 7731 Editor’s Note, Uniform Law Comment. The law requires only that the property be identifiable.” (p. 22).

A settlor of an irrevocable trust seeking to void the trust based on fraudulent inducement in the creation of the trust must prove the elements of common law fraud by clear and convincing evidence, including a material misrepresentation.

Here, the wife failed to prove fraudulent inducement because the husband’s failure to disclose the existence of the Florida properties was not a material misrepresentation. The wife’s intent at the time of the creation of the trust was to keep their marital assets in the family and ensure they were passed on to their children and the husband’s failure to disclose specific properties in Florida did not prevent this end. (p. 24).

Furthermore, the schedule of assets disclosed to the wife satisfied the requirements for trust creation in Pennsylvania. (p. 25). Thus, “Husband’s failure to identify the Florida Properties does not serve as a basis for voiding an otherwise valid, irrevocable trust agreement.”

* 1. **Ramirez v. Rodriguez, 2020 WL 806653 (Tex. Feb. 19, 2020)**

**Trustees established a prima facie case for the removal of a co-trustee by providing clear and specific evidence of the co-trustee’s hostile and unauthorized actions that impeded the proper performance of the trust**

In 1977, the Ramirez mineral trust was created and funded with a family’s oil, gas and mineral interests. The provisions of the trust agreement appointed four co-trustees to control, manage, develop, operate and lease the interests held by the trust and required that any action on behalf of the trust required the joinder of at least three of the four co-trustees. As of January 2019, the four acting co-trustees were Santiago Ramirez, Sonia Garza Rodriguez, Victor M. Ramirez and Javier Ramirez Jr.

On Feb. 7, 2019, Santiago and Ancient Sunlight, Ltd. (a beneficiary of the trust of which Santiago was the general partner), filed a lawsuit against Sonia in the District Court of Zapata County, alleging the trust’s employment of Sonia’s spouse as an independent contractor constituted breach of fiduciary duty and breach of trust.

On April 26, 2019, Sonia, Victor and Javier (collectively, the responding trustees), filed a petition to remove Santiago as a co-trustee of the trust pursuant to Section 113.082(a)(4) of the Texas Trust Code, alleging Santiago had created hostility and friction that impeded the operations of the trust since approximately 2007. The complaint alleged that Santiago (i) acted without the authority of the trust by unilaterally communicating with third parties, including government officials, fiduciary professionals and an opposing party in ongoing litigation; (ii) threatened and harassed the responding trustees; (iii) disclosed confidential trust information to third parties; and (iv) engaged in destructive behavior to the detriment of the trust, among many other hostile activities.

Santiago moved to dismiss the lawsuit under Section 27.003(a) of the Texas Civil Practice and Remedies Code, arguing that the cause of action was based on, related to or in response to the exercise of Santiago’s right of free speech and right to petition. The responding trustees filed a response and supplemental response asserting that Santiago failed to establish the cause of action was based on, related to or in response to the exercise of Santiago’s right of free speech and right to petition and attaching evidence to establish a prima facie case for Santiago’s removal.

The trial court held a hearing on the motion to dismiss, but did not rule on the motion. On the 30th day following the hearing, the motion was denied by operation of law. Santiago appealed the denial to the San Antonio Court of Appeals, arguing his motion to dismiss should have been granted.

Texas law authorizes a court to remove a trustee upon the petition of an interested party if the court finds cause for removal. Tex. Prop. Code § 113.082(a)(4). Although hostility or ill will between the trustee and beneficiaries alone is insufficient to establish cause for removal, a court may remove a trustee if such hostility or ill will affects the trustee’s performance or impedes the proper performance of the trust. *Bergman v*. *Bergman-Davidson-Webster Charitable Tr*., No. 07-02-04600-CV, 2004 WL 24968 at \*1 (Tex. App.— Amarillo Jan. 2, 2004, no pet.) (mem. op.); *Akin v*. *Dahl*, 661 S. W.2d 911, 913–14 (Tex. 1983).

Under Section 27.003(a) of the Texas Civil Practice and Remedies Code, a party may move for dismissal if a “legal action is based on, relates to, or is in response to [such] party’s exercise of the right of free speech [or] right to petition.” To establish grounds for dismissal, the moving party must show by a preponderance of the evidence that the “‘legal action is based on, relates to, or is in response to [the movant]’s exercise of the right of free speech’” or right to petition. *Dall*. *Morning News*, *Inc*. *v*. *Hall*, 579 S.W.3d 370, 376 (Tex. 2019) (quoting Tex. Civ. Prac. & Rem. Code Ann. § 27.003(a)). If the moving party meets this burden, the claimant must establish a prima facie case for each essential element of the cause of action by clear and specific evidence to overcome the motion to dismiss. *Id*.Review of an order granting or denying dismissal on this ground is *de novo*. *Id*. at 377. However, the pleadings and evidence must be considered “in the light most favorable to the nonmovant.” *Robert B. James, DDS, Inc*. *v*. *Elkins*, 553 S. W.3d 596, 603 (Tex. App.—San Antonio 2018, pet. denied). A court may award costs and reasonable attorney’s fees to the responding party if it determines a motion to dismiss filed pursuant to this provision is frivolous or intended solely to delay the proceedings. Tex. Civ. Prac. & Rem. Code Ann. § 27.009(b).

The San Antonio Court of Appeals affirmed the trial court’s denial of the motion to dismiss and remanded the issue of an award of costs and fees to the trial court.

Without determining whether Santiago proved by the preponderance of the evidence that the action at issue was based on, related to or in response to his exercise of the right of free speech or right to petition, the Court of Appeals concluded that the responding trustees established a prima facie case for the removal claim by clear and specific evidence. In coming to this conclusion, the Court of Appeals relied on communications provided by the responding trustees that illustrated Santiago’s general hostility and unauthorized acts with respect to the trust, including challenging professional fees, baselessly accusing other trustees of impropriety, disclosing confidential trust information to third parties and negotiating with a third party on the basis that the trust would be dissolved due to internal conflicts. The responding trustees also produced statements from a trust beneficiary that accused Santiago of acting without authority, sabotaging the trust, and acting destructively at the expense of the beneficiaries. Accordingly, the Court of Appeals upheld the denial of Santiago’s motion to dismiss.

The Court of Appeals remanded the issue of the award costs and fees to the trial court because the trial court had not yet considered whether Santiago’s motion to dismiss was frivolous or intended solely to delay the proceedings.

* 1. **Ferguson v. Ferguson, 473 P.3d 363 (Idaho Sept. 24, 2020)**

**As a matter of first impression, the Idaho Supreme Court held that no-contest provisions in trust agreements are generally enforceable in Idaho, but such enforceability is subject to various common law limitations. Additionally, a broad grant of discretion under the terms of a trust agreement will not excuse trustees from applicable fiduciary duties, including the duty to administer the trust in good faith and the duty to keep beneficiaries reasonably informed with relevant information**

Roger Ferguson and Sybil Ferguson (collectively, the grantors, and each, a grantor) created the Ferguson family revocable trust (the original trust), under which they excluded their son, Michael Ferguson, as a beneficiary. Under the terms of the trust agreement, the original trust would become irrevocable upon the death of the first grantor and the assets would be divided into subtrusts: the deceased grantor’s property and a one-half share of the community property would be distributed to the Roger Ferguson family trust and the Roger Ferguson nonexempt marital trust, while the surviving grantor’s separate property and one-half share of the community property would be distributed to a trust called the survivor’s trust. The trust agreement granted the surviving grantor the right to continue to serve as trustee of the subtrusts and designated three of the grantors’ children (not including Michael) and the grantors’ accountant as successor co-trustees of the trust (collectively, the successor trustees) upon the death of the surviving grantor.

Roger died in 2012, triggering the distributions to the subtrusts, and Sybil exercised her right to serve as trustee of the subtrusts. Under the trust agreement, Sybil, as trustee of the survivor’s trust, had broad discretion to distribute trust principal to herself. The following year, Sybil executed a will under which she exercised a power of appointment granted to her under the trust agreement and named Michael and various grandchildren as beneficiaries of the survivor’s trust.

The trust agreement also contained a “no-contest” provision providing that any beneficiary who “files suit on a creditor’s claim filed by the beneficiary in a probate [sic] of the estate of either Grantor ... after rejection or lack of action by the applicable fiduciary,” would be deemed to have predeceased the surviving grantor and, accordingly, forfeit any interest in the trust.

Sybil died in 2015, and her will was admitted to probate in Arizona. Three of her children (not including Michael) were appointed as co-personal representatives of her estate. On July 27, 2016, Michael filed a petition for accounting and performance of trustee duties requesting financial information regarding the original trust and subtrusts dating back to Roger’s death. The successor trustees asserted nine affirmative defenses to Michael’s petition and continued to withhold all information predating Sybil’s death.

On March 16, 2017, while Michael’s initial petition was pending before an Idaho magistrate court, Michael submitted a claim against Sybil’s estate, asserting that Michael was a creditor of the estate because Sybil, as trustee of the survivor’s trust, breached fiduciary duties owed to Michael. The co-representatives denied his claim, and Michael subsequently filed a petition for allowance of claim and for stay in the Arizona probate court, claiming the petition was necessary to preserve his claim while he litigated the Idaho matter. The parties agreed to stay the Arizona probate proceeding pending resolution of Michael’s Idaho petition.

Following the stay, Michael filed a motion for partial summary judgment on five of the successor trustees’ defenses. The successor trustees filed a supplemental affirmative defense and counterclaim for declaratory judgment, asserting that Michael’s Arizona petition breached the no-contest provision of the trust agreement, disqualifying Michael as a beneficiary of the trust. Michael responded with a motion to compel discovery, requesting financial documents related to the original trust. The successor trustees then filed a cross-motion for summary judgment, requesting judgment on their affirmative defense based on the no-contest provision or, in the alternative, in favor of other asserted affirmative defenses.

The magistrate court held a hearing on the cross-motions and issued a memorandum decision denying the successor trustees’ motion for summary judgment to enforce the no-contest petition, but granting summary judgment on five other affirmative defenses. The magistrate court concluded that Michael did not become a beneficiary of the survivor’s trust until after Sybil’s death, was not entitled to any records that preceded her death, and lacked standing to seek an accounting or other information regarding the original trust or the subtrusts. In light of these rulings, the court also denied Michael’s motion to compel discovery.

After a hearing on intermediate appeal, the Madison County District Court held that the magistrate court erred in finding that Michael was not a beneficiary until after Sybil’s death and instead concluded that Michael became a beneficiary of the survivor’s trust when Sybil exercised the power of appointment in her will. Additionally, the District Court held that (i) the magistrate court erred in refusing to apply the no-contest provision, (ii) Sybil did not owe a fiduciary duty to Michael because she had broad discretion over the assets of the survivor’s trust, and (iii) Michael did not have probable cause to bring the Arizona petition against her estate and had violated the no-contest provision. Michael appealed.

A trustee has a duty to administer the trust in good faith and in accordance with the terms of the trust agreement and applicable law. *Restatement (Third) of Trusts* § 76 (2007).While courts will not interfere with a trustee’s reasonable exercise of discretionary power based on a proper interpretation of a trust’s terms, they will not permit abuse of discretion by a trustee. *Restatement (Third) of Trusts* § 50 cmt. b. Even under the broadest grant of discretion, trustees have a general duty to be reasonably informed, act with impartiality among the beneficiaries and interests, and “to provide the beneficiaries with information concerning the trust and its administration.” *Id*.

Under Idaho law, a trustee has a duty to keep beneficiaries reasonably informed of the trust and its administration, I.C. § 15-7-303, and, upon a reasonable request, must provide a “beneficiary with a copy of the terms of the trust which describe or affect his interest and with relevant information about the assets of the trust and the particulars relating to the administration.” I.C. § 15-7-303(b). Further, Idaho recognizes a duty of loyalty that requires a trustee “to administer the trust in the interest of the beneficiaries alone, and to exclude from consideration his own advantages and the welfare of third persons.” *Taylor v*. *Maile*, 142 Idaho 253, 260 (2005). (quoting *Edwards v*. *Edwards*, 122 Idaho 963, 969 (Ct. App. 1992)) (internal quotation marks omitted). The term beneficiary includes any person who has a present or future interest in the trust, whether vested or contingent. I.C. § 15-1-201(3).

The enforceability of no-contest provisions in trust agreements was an issue of first impression in Idaho, but Idaho previously codified limitations on the enforceability of no-contest provisions in wills. SeeI.C. § 15-3-905. In the context of trusts as will substitutes, no-contest provisions “serve the same purpose as do such clauses in wills, and the same test applies to determine the validity of those clauses in the two comparable situations.” *Restatement (Third) of Property (Wills and Donative Transfers)* § 8.5 cmt. c. However, the majority of jurisdictions recognize various common law limitations to no-contest clauses. For example, actions “intended solely to procure time to ascertain the facts upon which the decision to institute a proceeding must rest should not be construed to constitute the institution of an action to contest.” *Id*.

Sybil owed Michael a fiduciary duty under the trust agreement and Idaho trust law because Michael’s interest in the survivor’s trust arose 18 months prior to Sybil’s death when she exercised the power of appointment and no grant of discretion will exempt a trustee from fiduciary duties imposed by Idaho law.

Under Idaho law, Michael, as a beneficiary of the survivor’s trust, was entitled to receive any relevant financial information relating to the original trust and subtrusts, including information that predates his interest in the survivor’s trust. There is no temporal restriction on the information a trustee has a duty to furnish to a beneficiary, so long as such information is relevant to the beneficiary’s interests, the assets of the trust or particulars of administration.

No-contest provisions in trust instruments are enforceable in Idaho, unless probable cause existed for instituting the proceeding such that it would contravene public policy to enforce the provision or enforcement of the provision would otherwise interfere with the enforcement or proper administration of the trust.

The no-contest provision in the present case was not enforceable with respect to Michael because it interferes with the proper administration of the survivor’s trust and Michael’s rights as a beneficiary. Under Idaho law, the successor trustees have a duty to keep Michael reasonably informed of the trust and its administration. Here, the successor trustees refused to produce relevant information that Michael reasonably requested pursuant to his right as a beneficiary and attempted to prevent Michael from accessing such information through enforcement of the no-contest provision. Further, Michael’s minimal actions to preserve his rights against Sybil’s estate while waiting to receive information through the Idaho litigation should not be construed to constitute a challenge.

Finally, since the district court did not reach the issue of Michael’s motion to compel discovery because it enforced the no-contest provision, the Supreme Court remanded the matter for reconsideration.

* 1. **Trowbridge v. Estate of Trowbridge, 150 N.E.3d 220 (Indiana June 11, 2020)**

**Under Indiana law, when offering a copy of a missing will for probate, the proponent’s failure to produce the decedent’s original will is not determinative of the proponent’s ability to rebut the presumption that the decedent destroyed the original will with the intent to revoke it**

Everett Thomas Trowbridge (the decedent) and Christal Trowbridge married in 2003 and divorced in 2012.

Everett Trowbridge subsequently died on June 6, 2018. On July 13, 2018, the decedent’s brother, Michael Trowbridge, filed a petition for issuance of letters of administration asserting that the decedent died intestate. The probate court granted Michael’s petition on July 16, 2018, and appointed him personal representative of the decedent’s estate.

On Nov. 13, 2018, Christal filed a petition for probate of will and appointment of co-personal representative with the probate court, asserting that the decedent died testate pursuant to a will dated April 30, 2012 (approximately two months after their divorce). Under the will submitted by Christal, the decedent appointed Christal and Michael as co-personal representatives and left Christal residential real estate, a retirement account, 25 percent of an additional retirement account, and all of his personal property. Michael objected to the probate of the will.

The probate court held a hearing in January 2019, during which Christal, Michael and the attorney for the estate, Michael Maschmeyer, testified to the facts and circumstances surrounding the execution of the decedent’s original will and its status as of his date of death. After the hearing, the probate court entered an order denying probate of the will on the basis that a presumption of revocation applied where a will that was in the possession of a testator is missing at the time of the testator’s death. Christal appealed the decision, and the Court of Appeals of Indiana reversed and remanded, finding that the estate had not been entitled to the presumption that the original will was destroyed with the intent to revoke without predicate factual findings.

The probate court held a second hearing in October 2019, during which Christal, Michael and Maschmeyer testified to additional facts and circumstances regarding the status of the will. The evidence established that the will offered by Christal was a copy of the decedent’s original will, which at one time had been kept in a safe in the decedent’s home, but was not found when Michael searched the decedent’s safe and home after his death. The probate court concluded that because Christal failed to prove by a preponderance that the will she offered for probate was the original will, she had not overcome the presumption of revocation, and it entered an order denying probate of the will. Christal again appealed the decision of the probate court.

When a copy of a will is offered for probate in place of the original, a contesting party has the burden of establishing that the original will was revoked. *Estate of Fowler* *v*. *Perry*, 681 N.E.2d 739, 741 (Ind. Ct. App. 1997). However, “where a testator retains possession or control of a will and the will is not found at the testator’s death, a presumption arises that the will was destroyed with the intent to revoke it.” *Id*. Such presumption shifts the burden to the proponent of the will to prove by a preponderance of the evidence that the testator did not destroy the original will with the intent to revoke. *Id*. Evidence that can rebut the presumption of revocation includes: (1) evidence of the testator’s intent when he allegedly revoked the will, (2) evidence relating to the ability of the testator to obtain access to the will during the alleged period of revocation, (3) evidence relating to the competency of the testator during the alleged period of revocation, and (4) evidence relating to the ability of interested parties to obtain access to the will before its disappearance. *Trowbridge*, 150 N.E.3d at 226 (citing *In re Estate of Borom*, 562 N.E.2d 772, 776 (Ind. Ct. App. 1990).

The Court of Appeals affirmed the probate court’s holding that the estate was entitled to the presumption of revocation based on the findings that the original will had been in the decedent’s possession, that Christal had offered a copy of the will for probate, and that the original will could not be found after the decedent’s death.

However, the Court of Appeals also held that the probate court erred in denying Christal’s petition solely because she was unable to offer the decedent’s original will for probate. Rather, the Court of Appeals concluded that the probate court should have engaged in the burden-shifting analysis set forth in *Estate of Fowler* to determine whether the testimony and exhibits offered by Christal could rebut by a preponderance of the evidence the presumption that the decedent’s will was destroyed with the intent to revoke. In coming to this conclusion, the Court of Appeals noted several facts in the record that could rebut the presumption of revocation, including: (i) the decedent did not execute his will until after his divorce; (ii) the decedent continued to list Christal as the beneficiary of his accounts as recently as 2018; (iii) the decedent never informed Christal that he had revoked his will; (iv) Michael had access to the decedent’s home and safe immediately following his death; and (v) Michael stood to gain more under intestacy laws if the will were barred from probate. Accordingly, the Court of Appeals reversed the probate court’s decision on this issue and remanded the case for further proceedings.

* 1. **Parris v. Ballantine, Supreme Court of Alabama, September 25, 2020 (not yet released for publication)**

**The Alabama Supreme Court held that a beneficiary’s adopted son, who was adopted as an adult, was not a “lineal descendant” of the child of the trustors entitled to take under the terms of trust, and therefore was not a beneficiary of the trust. The court concluded that, in 1971, Alabama law did not authorize the adoption of adults, and therefore, the trustors neither intended to include adopted children, nor did they have constructive knowledge of an adopted adult being included in the plain meaning of the phrase “lineal descendants” as used in their trust agreement**

In 1971, a married couple (the trustors) created a trust for their children and children’s descendants. The trustee was to make distributions of income and principal “to or among the issue of the primary descendant[s] and such issue’s lineal descendants.” In 2002, per court order, the 1971 trust was divided into three separate trusts, one for each of the trustors’ three children. One of the three trusts was created for the trustors’ daughter, Sarah Schutt Harrison and her four children. In a 2010 court order, the Jefferson County Probate Court subdivided the Harrison trust into four separate trusts, one for each of Sarah Schutt Harrison’s four children (the sibling trusts), including one for Aimee Harrison Parris. The provisions of the sibling trusts were to be consistent with the 1971 trust. If there were no lineal descendants remaining as beneficiaries of a sibling trust, such sibling trust would be divided among the remaining sibling trusts.

Prior to her death in February 2017, Aimee Harrison Parris adopted her husband’s adult biological son, Samuel, in 2016. Aimee did not have any other adopted or biological children.

In March 2017, the trustee of Aimee’s trust filed a petition for final settlement of Aimee’s trust before the probate court. In response, Aimee’s three siblings filed an answer and cross-claims against the trustees and Samuel before the probate court seeking a determination that Samuel was not a lineal descendant entitled to take under the terms of the 1971 trust because he was adopted as an adult. Accordingly, the siblings argued, the remaining assets of Aimee’s trust should be divided and distributed among the other three sibling trusts. The 1971 trust defined “lineal descendants” as “those hereafter born, either before or after trustor's death, as well as those now in existence. A child en ventre sa mere shall be deemed to be living.”

Samuel argued that under the 2010 court order, adopted children were meant to be included as beneficiaries of the sibling trusts because, when entering the 2010 court order, the Supreme Court of Alabama made it clear that “lineal descendant” included adopted children. Additionally, Samuel argued that the guardian *ad litem* appointed in the 2010 proceeding represented “all unborn, unconceived, and unascertainable income and remainder beneficiaries,” which should be construed to include children adopted in the future, such as himself. In 2019, the probate court ruled in favor of the three siblings, holding that the 1971 trust was not ambiguous and that adopted children were not included in the 1971 trust’s meaning of “lineal descendants” and, therefore, Samuel was not a beneficiary of Aimee’s trust. Samuel appealed the probate court decision.

The Supreme Court of Alabama applied a *de novo* standard of review, holding that the construction and interpretation of an unambiguous document is a question of law for the court to decide.

Additionally, the court determined that the 1931 statute, relied upon by Samuel, addressed adopted *children*, not individuals adopted as adults.

The Supreme Court of Alabama affirmed the probate court’s holding because Samuel’s adoption was not contemplatable at the time the 1971 trust was executed, thus excluding him from the meaning of “lineal descendants” as used in the 1971 trust. Thus, Samuel was not a beneficiary of Aimee’s trust. The majority opinion was sure to include that the holding was specific to the unique facts of this case, which involved adult adoptions, and should not be read to apply to adoptions of minors.

The dissenting Justice first contended that the full faith and credit clause of the U.S. Constitution should require the Alabama courts to give full faith and credit to the adoption decree executed by Aimee, which created the parent-child relationship between Aimee and Samuel. Next, the dissenting Justice argued that the phrase “hereafter born” was meant only to reference a time frame for descendants to be born, and was not specifically intended to exclude other means of becoming a descendant than by birth (such as by adoption). The fact that Samuel was born in 1993, after the 1971 trust was established, and later became a legal child of Aimee, was conclusive to the dissenting Justice, and should have made him a lineal descendant of Aimee and a beneficiary of Aimee’s trust.

* 1. **Pena v. Dey, 39 Cal. App. 5th 546, 548, 252 Cal. Rptr. 3d 265, 266 (2d. Dist 2019)**

**The California Third District Court of Appeal held that the settlor’s handwritten interlineations did not satisfy trust’s amendment provisions, which required amendments to be signed by the settlor, and therefore the interlineations did not effectively amend the trust**

In 2004, James Robert Anderson executed the James Robert Anderson revocable trust and designated himself as the settlor and trustee. The trust provided that “any amendment, revocation, or termination of this trust shall be made by written instrument signed by the settlor.... An exercise of the power of amendment substantially affecting the duties, rights, and liabilities of the trustee shall be effective only if agreed to by the trustee in writing.” Anderson later executed a first amendment in compliance with the trust’s requirements.

In February 2014, Anderson consulted an attorney to amend his estate planning documents. The attorney, unfamiliar with Anderson’s prior documents, asked for copies of the trust and the first amendment, and asked for a writing of Anderson’s requested changes. Anderson made interlineations on the face of the copies of his existing estate planning documents and sent the markup to his attorney. Accompanying the copies was a note that read, “Hi, [attorney], Here they are. First one is 2004. Second is 2008. Enjoy! Best, Rob.” The interlineations changed the beneficiaries listed in the first amendment, adding Grey Dey as a beneficiary. Anderson’s attorney required further clarification as to Anderson’s intent based on the interlineations, and called Anderson to get more information. Anderson was unavailable to answer his attorney’s questions, and ended up passing away before connecting with his attorney to clarify the requested changes. As a result, the interlineations were never formally inserted into Anderson’s estate plan by a signed writing.

Margaret Pena, the successor trustee of the trust, petitioned the trial court for instructions as to the validity of the interlineations. She thereafter moved for summary judgment, asserting the interlineations did not amount to a valid amendment to the trust as a matter of law. The trial court granted the motion and entered judgment in Pena's favor. Dey appealed.

Under the California Probate Code, a revocable trust “may be revoked in whole or in part by any of the following methods:

(1) By compliance with any method of revocation provided in the trust instrument.

(2) By a writing, other than a will, signed by the settlor or any other person holding the power of revocation and delivered to the trustee during the lifetime of the settlor or the person holding the power of revocation.

If the trust instrument explicitly makes the method of revocation provided in the trust instrument the exclusive method of revocation, the trust may not be revoked” by other means pursuant to the California probate code.

In this case, the trust instrument provided that any amendment to the trust “shall be made by written instrument signed by the settlor and delivered to the trustee.” The California Third District Court of Appeal found that the interlineations constituted a written instrument separate from the trust agreement, and since he was both settlor and trustee, it was indisputable that Anderson delivered the interlineations to himself when he made them. However, Anderson did not sign the interlineations, and as a result, the court found that the interlineations did not effectively amend the trust instrument.

The court rejected Dey’s argument that Anderson validly adopted his 2008 signature on the first amendment to the trust when he made the interlineations to that document in 2014. Dey cited cases supporting the proposition that handwritten interlineations made to a holographic (handwritten) will or codicil after that instrument was signed, when made with testamentary intent, become part of that will or codicil and adopt the original date and signature. The Court declined to apply the handwritten changes to a non-holographic document. The court reasoned that in the context of a holographic will, subsequently added handwritten interlineations become part of that signed holographic will and they become a single testamentary document. In contrast, handwritten interlineations on a non-holographic trust document are a separate writing. The trust instrument in this case required such an amendment to be signed by the settlor, which the court determined would be useless if handwritten changes could be made without an accompanying signature.

The court further rejected Dey’s argument that the note attached to the trust documents constituted Anderson’s signature. The court reasoned that the note was a separate writing that simply identified the enclosed documents and that if the changes and note were sufficient to qualify as a signed writing, there would have been no need for Anderson to send them to his attorney to put into a formal amendment that he would later sign. Because Anderson died prior to signing the new amendment, however, these changes were never incorporated into his trust.

* 1. **Cundall v. Mitchell-Clyde, 51 Cal. App. 5th 571, 265 Cal. Rptr. 3d 254 (2020)**

**California Appellate Court held that, to eliminate the availability of the statutory method of trust revocation provided in section 15401 of the California probate code, a trust agreement must provide an alternative method of revocation and provide an express statement that such alternative method of revocation is the exclusive method available**

Martin, Cundall and Diaz were all neighbors in West Hollywood. After meeting in 2007, Cundall began remodeling Martin’s house. The quoted price of the remodel was $81,000, but it ended up costing $219,000.

Later, Diaz, an attorney, drafted a trust for Martin, which Martin eventually executed (the February trust). The February trust stated the following:

“During the Grantor's lifetime, the Grantor may revoke at any time, and/or the Grantor may amend, this Agreement by delivering to the Trustee and the Successor Trustee an appropriate written revocation or amendment, signed by the Grantor and his attorney, Frances L. Diaz. The powers of amendment may be exercised by a duly appointed and acting attorney-in-fact for the Grantor for the purpose of withdrawing and/or distributing assets from the Trust.”

Shortly after executing the February trust, Martin began suspecting Diaz and Cundall of stealing from him, so he retained new counsel, Kanin. Kanin believed Martin was lucid and rational, and began preparing a new estate plan for Martin (the May trust), as well as a revocation of the February trust. The May trust named Mitchell-Clyde and Ronald Preissman, two friends of Martin’s, as beneficiaries. Preissman was also named the successor trustee. The revocation stated, in full, that “[t]he undersigned, John W. Martin, as Grantor and Trustee, hereby revokes the John W. Martin Living Trust Dated February 11, 2009,” and was signed by Martin. Both the May trust and the revocation were signed May 12, 2009.

Upon learning of Martin’s new estate plan, Diaz raised concerns with Kanin and Preissman, as well as Martin’s doctor, that Martin was not lucid. The relationship among Martin, Cundall and Diaz continued to deteriorate. Martin died in January 2010.

In September 2010, Cundall filed a petition in the Superior Court of L.A. County for a determination that the February trust had not been revoked and that the trust assets therefore belonged to him. Clyde and Preissman filed an objection, as well as a separate petition, seeking a determination that the February trust was revoked and the May trust was valid and enforceable. In 2018, the trial court issued a final decision that Martin did have the capacity to execute the May trust, and that there was no basis to conclude that the February trust could only be revoked upon Diaz’s consent. Thus, the February trust was properly revoked according to the trial court.

On appeal before the Court of Appeal, Second District, of California, Cundall argued first that Diaz had been appointed as a “trust protector” and therefore her consent was required to revoke the February trust, and thus the statutory method of revocation did not apply to the February trust. In the alternative, Cundall argued that the February trust required an “exclusive” method of revocation.

The appellate court first cited section 15401 of California’s probate code, which provides two methods of trust revocation:

1. A trust may be revoked by compliance with any method of revocation provided in the trust instrument.

2. A trust may be revoked by a writing, other than a will, signed by the settlor or any other person holding the power of revocation and delivered to the trustee during the lifetime of the settlor or the person holding the power of revocation (the statutory method of revocation).

Section 15401(a)(2) of the California probate code provides one exception to the alternative means of statutory revocation: “If the trust instrument explicitly makes the method of revocation provided in the trust instrument the exclusive method of revocation, the trust may not be revoked pursuant to this paragraph.”

The Court of Appeals rejected Cundall’s argument that the alternative revocation method in section 15401 does not apply to trusts that establish a “trust protector” because section 15401 is limited to the “method” of revoking a trust rather than the authority to revoke. The Court of Appeals rejected this argument, finding that a trust document must contain explicit statements that limit the trust’s revocation methods, and otherwise, the statutory revocation method is available, regardless of the presence of a “trust protector.” The Court of Appeals reasoned that granting an individual the authority to approve revocation is not relevant to the “method” of revocation as contemplated by section 15401.

The Court of Appeals further reasoned that, if anything, Diaz may have had the authority to revoke, in addition to Martin’s authority, but Martin’s revocation was not conditional upon Diaz’s consent, and nothing in the legislative history of section 15401 shows an intent to limit a settlor’s right to revoke his or her trust. The Court of Appeals found that retaining authority in a settlor to revoke a trust absent explicit surrender of that authority is consistent with the modern statutory scheme, as the current rule protects “the clear intention of the settlor who attempts to revoke a revocable trust by the statutory method.” Finally, the appellate court determined that section 15401 would simply require that the trust explicitly state that a trust protector’s consent was required as a part of the *method* of revoking a trust. Again, the Court of Appeals did not equate the granting of authority to Diaz to consent to revocation as an explicit statement that Diaz’s consent was a required component of the method of revocation.

The Court of Appeals went on to find that the February trust may have laid out a particular method of revocation but it did not include any language to state that it was the “exclusive” method of revocation, thus allowing the statutory method of revocation to be available. Therefore, the statutory method of revocation followed by Martin and Kanin was available and adequately revoked the February trust. Accordingly, the trial court’s holding that the February trust was revoked was affirmed.

**OTHER ITEMS OF INTEREST**

* 1. **United States v. Johnson, \_\_\_ F. 3d \_\_\_\_ (10th Cir. 2019)**

**Four children held responsible for unpaid federal estate taxes on stock received from mother’s trust following mother’s death**

Anna Smith created the Anna Smith Family Trust during life and funded it with shares of stock in State Line Hotel Inc. The trust was governed by Utah law. The hotel was a closely-held corporation and the holder of a Nevada Gaming License. Anna died on September 2, 1991. Upon Anna’s death, two of her children, Mary Johnson and James Smith, were named as successor trustees of the trust and as personal representatives of the estate. Her four children were the beneficiaries of the trust.

Consistent with the terms of the trust, the successor trustees filed a federal estate tax return with the Internal Revenue Service. The return calculated the estate’s federal estate tax liability at $6,631,448. Of that total, only $4 million was paid to the IRS upon the filing of the return. The successor trustees elected to defer the payment of the balance of the estate tax for five years and then pay the balance in ten equal annual installments under Section 6166 because the hotel stock accounted for more than 35 percent of Anna Smith’s adjusted gross estate and was illiquid. The ten annual installment payments would begin on June 2, 1997 and end on June 2, 2006.

Although the assessed estate taxes remained unpaid, the successor trustees distributed the hotel stock from the trust to the four children on December 31, 1992. The distribution was motivated by restrictions under Nevada law on casino ownership by a trust. The trustees also distributed life insurance proceeds. Cognizant of the outstanding federal estate tax liability, the successor trustees and the trust beneficiaries executed a distribution agreement under which the beneficiaries agreed to bear the responsibility for paying additional federal or state estate taxes, interest, or penalties.

The hotel filed for Chapter 11 bankruptcy in January 2002. Beginning with the annual installment due on June 2, 2002, the estate ceased making the installment payments of deferred federal estate tax. The Service declared the installment agreement to be in default as of December 18, 2003. In June 2005, the IRS learned of the existence of the distribution agreement in which the beneficiaries agreed to pay the estate taxes. In 2011, the government filed a complaint against the four children seeking recovery of the $1,569,851 in federal estate tax. The government alleged that all four of decedent’s children were liable for the unpaid estate taxes to the extent that they received property included in the gross estate under Section 6324(a)(2). The district court determined that this claim could only be asserted as to life insurance proceeds received by the children as part of the distribution from the estate because the children conceded liability for the on those proceeds.

The government filed an amended complaint in August 2012. In the amended complaint, the government sought to enforce rights as a third party beneficiary of the distribution agreement. The district court ruled in favor of the four children concluding that it was untimely under Utah law and rejecting the government’s argument that the timeliness of the claim was governed by federal law. The district court also awarded attorney’s fees to the children on the grounds that the government’s position on the third party beneficiary claim was not substantially justified.

In the circuit court, the children conceded the government was a third party beneficiary in the distribution agreement but argued the claim was untimely because it was not filed within the six year Utah statute of limitations applicable to contract claims. The circuit court reversed. Instead, the circuit court found that the ten year federal statute of limitations set forth in Section 6502(a) applied based on United States v. Summerlin, 310 U.S. 414 (1940). In that case, the Supreme Court held that “the United States is not bound by state statutes of limitations…in enforcing its rights.” The court also ruled with respect to the district court’s conclusion the government’s claim with respect to insurance proceeds was timely filed. It found that the ten-year federal limitations period was suspended pursuant to Section 6503(d) because the estate made a Section 6166 deferral election. This suspension also applied to transferee liability.

The Tenth Circuit also reversed the district court’s award of fees and costs to the children because it ruled in favor of the government on its claim that the four children were liable for the full amount of the unpaid estate taxes since the government was a third party beneficiary to the distribution agreement.

* 1. **Goodrich v. United States, \_\_\_\_F.3d \_\_\_\_\_\_ (5th Cir. 2021)**

**Fifth Circuit refers questions on ownership interest of children in usufruct interest seized by IRS for back taxes owed by father to Louisiana State Supreme Court**

The executor and the children of Henry Goodrich Sr. sued the IRS alleging that it had wrongly levied their property which they had inherited from their deceased mother, Tonia Goodrich, subject to Henry Sr.’s usufruct. At the district court level, the magistrate judge determined that the children were not the owners of money seized by the IRS that represented the value of certain liquidated securities that had been part of the usufruct interest.

Henry Sr. and Tonia, who were residents of Louisiana, owned community property during their marriage. The community property included shares of stock and stock options in Goodrich Petroleum Corporation (the “Goodrich Securities”). Tonia died in 2006 and the administration of her estate was completed in 2015. Tonia left her interest in some of the community property, including the Goodrich securities, to her children subject to Henry Sr.’s usufruct. During his life, Henry Sr. sold $857,914 worth of the Goodrich securities. One half of that amount, $428,957, belonged to Henry Sr. as his community interest in the property, while the other half was attributed to the children’s “naked ownership” subject to Henry Sr.’s usufruct.

Henry Sr. died in March 2014 having failed to pay $214,806 in income tax for 2012, $312,078 for 2013, and $38,029 for 2014. Henry Sr.’s executor opened a succession checking account. In April 2017, the IRS placed a levy on the checking account in order to collect Henry Sr.’s unpaid taxes. In May 2017, the bank remitted all the remaining funds of within the checking account (which equaled, $239,927) to the IRS. The IRS applied that amount to Henry Sr.’s 2012 tax liability which also included penalties and interest and totaled $238,922 as of the date of Henry Sr.’s death. A combined outstanding balance of $471,818 remained on Henry Sr.’s 2013 and 2014 tax liability.

Subsequently in April 2017, the executor and the children sued the IRS, alleging that it had wrongfully levied those funds and had taken money that actually belonged to the plaintiffs as the owners of nearly $500,000 worth of liquidated Goodrich securities.

The parties filed cross motions for summary judgment. Without considering whether he had subject matter jurisdiction to entertain plaintiffs’ claim, the magistrate judge partly granted and partly denied the motions for summary judgment by the plaintiffs and the government and issued a final judgment in which he ordered the IRS return $86,774, which represented the children’s share of the proceeds from the sale of personal property and oil and gas revenues that had been deposited into the succession checking account. The magistrate judge, however, held that the children were not entitled to any funds attributable to their portion of the liquidated Goodrich securities. The magistrate reasoned that the IRS’s claim to that money took priority over that of the children since they were “unsecured creditors” of Henry Sr.’s succession. The magistrate relied on a Louisiana appellate court decision and the *Louisiana Civil Law* Treatise.

It its review, the Fifth Circuit determined that the requisite question was whether the children had demonstrated the requisite interest in the disputed funds to challenge the IRS’s ability to collect the tax under Section 7426(a)(1).

Three elements were necessary to show a wrongful levy:

1. the IRS filed a levy against property held by a non-taxpayer plaintiff.

2. the plaintiff has an interest in the property superior to that of the IRS; and

3. the levy was wrongful.

To challenge a wrongful levy, the plaintiff must have a fee simple or equivalent interest, a possessory interest, or a security interest in the property levied upon. Austin & Laurato, P. A. v. United States, 539 F.App’x 957, 960 (11th Cir. 2013) (per curiam).

Plaintiffs acknowledged the government prevailed if they were creditors rather than owners of the money. The determination of plaintiffs’ interest was a matter of Louisiana state law. In order to make a decision, the Fifth Circuit had to look to a final decision of the Louisiana Supreme Court. The court noted that no Louisiana court had decided the precise issue of whether the naked owner of an interest subject to a usufruct occupies the status of owner or creditor.

The Fifth Circuit decided that it was appropriate to certify two questions to the Louisiana Supreme Court in order to be able to render a decision in this case. The questions were

1. Does a usufructory’s testamentary usufruct of consumables render naked owners unsecured creditors of the usufructory’s succession?

2. If not, what is the naked owner’s relationship to those consumables?”

The Fifth Circuit will resolve the case in accordance with any opinion provided by the Louisiana Supreme Court.

* 1. **Khan v. United States, \_\_\_\_F.3d \_\_\_\_\_\_ (2d Cir. 2021)**

**Second Circuit upholds district court’s decision assessing a principal penalty amount of 50 percent of the balance of foreign bank accounts for failure to file a timely report of foreign bank financial accounts**

This was an appeal from a decision of the Eastern District of New York. The decedent, Harold Kahn, failed to file a Report of Foreign Bank and Financial Accounts (“FBAR”) for his two foreign bank accounts whose balances totaled $8,529,456 at the time of the failure to file in 2009. The district court granted the government's motion for summary judgment on the ground that under 31 U.S.C. § 5321, as amended in 2004 (the “2004 Statute”), the maximum permissible penalty for Kahn’s failure to file a FBAR was 50 percent of the aggregate balance in the accounts at the time of the failure to file. The district court rejected the contention of Kahn’s estate that the government’s authority to impose penalties for willful FBAR violations is limited by a 1987 Treasury Department Regulation, 31 C.F.R. § 1010.820(g)(2) to $100,000 per account (the “1987 Regulation”).

On appeal, the estate pursued its contention that the 1987 Regulation trumped the later-amended statute. The Second Circuit concluded that the district court correctly ruled the penalty limitations provided in the 1987 Regulation, which reflected the penalty provision in the 1986 version of the statute, were superseded by the 2004 amendment to the statute increasing the penalty maximum and affirmed the decision of the district court.

* 1. **Shaffer v. Commissioner of Revenue \_\_\_\_\_\_\_ Mass. \_\_\_\_\_\_ (2020)**

. **Petition for writ of certiorari denied by United States Supreme Court (November 9, 2020)**

**Massachusetts Supreme Judicial Court addresses impact of federal QTIP election on calculation of Massachusetts estate tax**

The issue in Shaffer was whether the intangible assets in a qualified terminable interest property (QTIP) Trust, which was created by predeceasing spouse in New York, were subject to the Massachusetts Estate Tax when the surviving spouse moved to Massachusetts after the death of the first spouse and died while domiciled in Massachusetts. Robert Chuckrow died in July, 1993 while domiciled in New York. His will established a QTIP trust for the benefit of his wife, Adelaide. The trust qualified as a QTIP Trust under both federal and New York law. At the time of Robert’s death, the trust assets totaled $844,101.27 and consisted entirely of intangible property. After Robert’s death, his estate filed federal and New York estate tax returns. On both returns, the estate reported no tax due, claiming the marital deduction in the full amount of the assets in the trust. Adelaide died domiciled in Massachusetts in 2011. The executors of Adelaide’s estate included the value of the QTIP trust assets in computing her federal estate tax, but excluded the QTIP trust assets in computing her Massachusetts estate tax. The Massachusetts Commissioner of Revenue audited the estate’s Massachusetts return and assessed an additional Massachusetts estate tax of $1,809,141.88 based on the $13,251,469 date-of-death value of the QTIP assets.

The estate raised two arguments in claiming that the QTIP trust assets were not subject to Massachusetts estate tax. The first argument was that there was only one transfer of QTIP assets, which transfer took place when Robert died in New York, and therefore the Massachusetts assessment of tax violated the due process clause of the Fourteenth Amendment and Article 10 of the Massachusetts Declaration of Rights because there was no transfer of the property in the QTIP trust at Adelaide’s death. The second argument was that the QTIP assets were not includable in Adelaide’s Massachusetts estate because the definition of “Massachusetts gross estate” in G.L.c. 65C, § 1(f) excludes QTIP property for which only a federal, but not a Massachusetts, QTIP election was made.

The Appellate Tax Board rejected both of the estate’s arguments. The Appellate Tax Board first determined that there are two transfers of QTIP assets. The first transfer is from the estate of the first spouse to the surviving spouse when the QTIP election was made for the assets in the trust. The second is from the estate of the surviving spouse to the designated beneficiaries when the surviving spouse dies. The appellate tax board based its decision upon Section 2044(c), which provides, in part, that QTIP property “shall be treated as passing from” the surviving spouse. A passing is the same as a transfer. The second transfer of QTIP assets occurred in Massachusetts and provided the constitutional basis for subjecting the property in the trust to Massachusetts estate tax.

The Appellate Tax Board also rejected the estate’s statutory argument. In a somewhat challenging analysis, it stated that the provision on which the estate relied, G.L.c. 65C, § 1(f), was inapplicable because, in effect, not only does it apply only *to* property for which a Massachusetts QTIP election was made (as the estate, in effect, had argued), but it applies only *when* there was property for which a Massachusetts QTIP election was or could be made, subjecting the survivor’s estate to tax only to the extent of that prior Massachusetts QTIP election. Because, in this estate, there had been no such property in a predeceased spouse’s estate, G.L.c. 65C, § 1(f) did not apply. Instead, G.L.c 65C, §2A(a) governed and caused the imposition of Massachusetts estate tax on all assets reported in the federal gross estate.

The Massachusetts Supreme Judicial Court first accepted the Appellate Tax Board’s conclusion that a transfer occurred upon the death of Adelaide, and therefore the decedent’s domicile in Massachusetts provided the constitutional basis for Massachusetts to tax the trust assets. The Court noted that in Fernandez v. Wiener, 326 U.S. 340 (1945), the U. S. Supreme Court stated that an estate tax is not limited to literal transfers at death, but “extends to the creation, exercise, acquisition, or relinquishment of any power or legal privilege which is incident to the ownership of property.” It also noted that the federal QTIP rules create fictional transfers in Section 2044(c). Although the surviving spouse receives only a lifetime income interest from the predeceased spouse, the Internal Revenue Code treats property subject to QTIP elections as passing in full from the predeceasing spouse to the surviving spouse. As a result, two transfers of QTIP property occurred for estate tax purposes. Adelaide’s domicile in Massachusetts at the time of her death provided a sufficient nexus to impose the Massachusetts estate tax on the transfer of the QTIP assets that was deemed to occur at her death.

In addition, as the Appellate Tax Board held, the statutory definition of the Massachusetts gross estate, which Adelaide’s estate tried to use to avoid the imposition of the tax, applied only where the predeceasing spouse made a Massachusetts QTIP election for property that is included in the Massachusetts gross estate of the predeceasing spouse. Robert’s estate did not make a Massachusetts QTIP election, nor was there otherwise any Massachusetts QTIP property in the QTIP trust. As a result, under G.L.c 65(c), § 2A, all assets of the estate reported in the federal gross estate would be subject to Massachusetts estate tax.

The estate filed a petition for a writ of certiorari with the U.S. Supreme Court on October 8, 2020 which was denied on November 9, 2020.

Two prior state law cases addressed essentially the same issue. In Comptroller of the Treasury v. Taylor, 189 A.3d 799 (Md. Ct. Spec. App. July 25, 2018), reversed by Maryland Court of Appeals, 21-C-15-055059 (July 29, 2019), the Maryland Court of Appeals addressed the impact of the federal QTIP election on the calculation of the Maryland estate tax at the death of the second spouse. This same issue was addressed in New York in the case of In re Estate of Seiden, NYLJ 10/12/18 p. 23, col. 5 (N.Y. County Surr. Ct.) and by the New York State Legislature in its April 2019 Executive Budget.

The facts in these two cases were simple; however, the consequences could have been complex if the Maryland Court of Appeals (the highest court in Maryland) had not reversed the decision of the Maryland Court of Special Appeals in Taylor in 2019 and if the New York legislature had enacted legislation in 2019 to counter the decision in Seiden. Congress added Section 2056(b)(7) to the Code to permit QTIP trusts to permit the first spouse to die to retain control over the ultimate disposition of the property in a marital trust which would qualify for the estate tax marital deduction Even though the trust for the surviving spouse did not need any of the traditional features that by their terms would include the value of the trust assets in the surviving spouse’s gross estate – such as a general power of appointment in the case of Section 2056(b)(5) – that inclusion in the surviving spouse’s gross estate was assured by 2044, providing for inclusion whenever a marital deduction was allowed under Section 2056(b)(7) or 2523(f), backstopped by Section 2519 in the case of the surviving spouse’s actions during life. This maintained the fundamental character of the marital deduction as a deferral only – the asset escapes tax at the first death but is taxed at the second death.

Since the 2001 Tax Act and the three-year phase-out of the credit for state death taxes between 2002 and 2005, and especially with state legislatures setting their estate tax exemptions lower than the federal basic exclusion amount, some states that still have an estate tax have provided for a state-only QTIP election, available when the estate is under the federal exclusion amount but not under the state exemption, or applicable to the extent the state exemption is less than the federal exclusion amount. But symmetry is lost to the fact that a state is powerless when the surviving spouse moves out of the state. “Worldwide,” or nationwide taxation is not allowed for the states, and, under Section 1 of the Fourteenth Amendment to the U.S. Constitution, a citizen of one state loses that citizenship merely by moving to another state.

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

The Maryland Tax Court held in 2015 that the QTIP property should be taxable as part of the Maryland estate of the surviving spouse. The circuit court then held in 2016 that the federal QTIP election simply enabled the trust assets to be taxable as part of the federal estate. The QTIP election did not convert the trust assets into the personal property of the surviving spouse, which could be subjected to Maryland estate tax.

The Maryland Court of Special Appeals in 2018 affirmed the circuit court and held that Maryland cannot tax the QTIP trust because no Maryland QTIP election had been made. The court cited Code of Maryland-Tax-General § 7-309(b)(6)(i) (emphasis added):

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

The Maryland Court of Appeals reversed the Maryland Court of Special Appeals in 2019. It held that the state did not seek to tax the property of the first spouse to die or the transfer of the first spouse’s property but to tax the deemed transfer of the QTIP property upon the surviving spouse’s death as a Maryland resident. The Court of Appeals found § 7-309(b)(6) to be irrelevant since it read that section as only applying to augmenting the Maryland estate with additional property. The QTIP property was included in the surviving spouse’s estate under federal law and there was no additional property to augment the Maryland estate. It concluded that the plain language and the legislative history of the pertinent provisions of the Maryland Code revealed that the value of the surviving spouse’s estate was the same for federal and Maryland estate tax purposes. Interpreting the statutes otherwise could result in a loophole (as noted in the concurring opinion) where Maryland “would tax only the QTIP trusts that were elected in Maryland estate tax returns, and not QTIP trusts that created in other States, where the beneficiary of the trust resided in Maryland at the time of death.”

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

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

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

The New York State Legislature enacted corrective action to address Seiden in the Executive Budget that Governor Cuomo signed into law on April 12, 2019. The legislation increases the New York taxable estate of a surviving spouse by the value of the property in the marital trust created at the first spouse’s death for which a QTIP election was made for New York estate tax purposes even if a federal QTIP election was not made for the marital trust. This provision is effective for estates of decedents dying on or after April 1, 2019.

* 1. **Changes in State Death Tax Exemptions from 2020 to 2021**

**Numerous changes occur in state death tax exemptions for 2021 because of legislation or inflation adjustments**

As in past years, there have been numerous changes in the exemptions allowed from the separate estate taxes that twelve states and District of Columbia apply in addition to the federal estate tax. An additional five states have separate inheritance taxes. The full state death tax chart which shows the death taxes applicable in the different states is found in the next item.

**Legislative Activity.** Connecticut, Vermont, and the District of Columbia each saw increases in their state exemptions pursuant to legislation. Connecticut increased its state death tax exemption from $5,100,000 in 2020 to $7,100,000 in 2021 and Vermont increased its exemption from $4,250,000 in 2020 to $5,000,000 in 2021. The District of Columbia reduced its exemption from $5,762,000 in 2020 to $4,000,000 in 2021. The District of Columbia’s exemption will be indexed for cost of living beginning in 2022. Iowa passed a phase-out of its inheritance tax on others than ascendants and descendants in which the tax rate is reduced 20 percent each year beginning in 2021 so that the inheritance tax is phased-out completely as of January 1, 2025.

**Indexing Exemptions for Inflation.** One development to which estate planning professionals need to pay attention is the increases in the exemptions as a result of inflation adjustments provided in some, but not all, of the states with separate state estate taxes. This area is increasingly complex. The federal estate death exemption was increased to $10,000,000 (adjusted for inflation) in 2018 as part of the 2017 Tax Act. The 2021 federal exemption is $11,700,000. No state with a state death tax has yet increased its separate state death tax exemption to match the federal exemption although Connecticut is currently scheduled to increase its exemption to match the federal exemption starting in 2023.

Maine, New York, and Rhode Island each adjusted their state death tax exemption for inflation in 2021. In addition, Hawaii, although it appears that its exemption is supposed to be adjusted for inflation, has failed to do so since 2018.

Finally, the State of Washington has not adjusted its exemption for inflation since 2018. In 2018, the Washington State Department of Revenue sent a notice stating that pursuant to Revised Code of Washington § 83.100, the department must adjust the Washington applicable estate tax exclusion map annually using the Seattle-Tacoma-Bremerton Metropolitan Area October Consumer Price Index (Seattle CPI). As of January 1, 2018, the U.S. Bureau of Labor and Statistics no longer calculated Seattle CPI. Instead, the Bureau of Labor and Statistics is calculating CPI for the Seattle-Tacoma-Bellevue core base statistical area. As a result of these changes, the term Consumer “Price Index” as defined in the statute did not match the current CPI measure calculated by the United States Bureau of Labor Statistics. Consequently, there has been no increase in the exemption in Washington State since 2018.

All of these different changes in recent years mean that only two states have the same exemption from state death tax. These are Massachusetts and Oregon, which each have the lowest state death tax exemption of any of the states, at $1,000,000.

The changes in the exemptions for those states with a state estate tax and the District of Columbia from 2020 to 2021 are summarized in the chart below:

**Changes in Exemptions in State Death Taxes – 2020-2021**

| **State** | **2020 State Death Tax Exemption** | **2021 State Death Tax Exemption** |
| --- | --- | --- |
| Connecticut | $5,100,000 | $7,100,000 |
| District of Columbia | $5,762,400 | $4,000,000 |
| Hawaii | $5,490,000 | $5,490,000 |
| Illinois | $4,000,000 | $4,000,000 |
| Maine | $5,800,000 | $5,870,000 |
| Maryland | $5,000,000 | $5,000,000 |
| Massachusetts | $1,000,000 | $1,000,000 |
| Minnesota | $3,000,000 | $3,000,000 |
| New York | $5,850,000 | $5,930,000 |
| Oregon | $1,000,000 | $1,000,000 |
| Rhode Island | $1,579,922 | $1,595,156 |
| Vermont | $4,250,000 | $5,000,000 |
| Washington | $2,193,000 | $2,193,000 |

Planners must be especially careful in planning for clients who reside in a state with a state estate tax or the District of Columbia or who have property located in state with a state estate tax and subject to that state’s estate tax. The different exemptions can make this planning quite complicated.

* 1. **2021 State Death Tax Chart (as of July 26, 2021)**

| **State**  **Type of Tax** | **Current Law** | **2021 State Death Tax Threshold** |
| --- | --- | --- |
| Alabama  None | Tax is tied to federal state death tax credit.  AL ST § 40-15-2. |  |
| Alaska  None | Tax is tied to federal state death tax credit.  AK ST § 43.31.011. |  |
| Arizona  None | Tax was tied to federal state death tax credit.  AZ ST §§ 42-4051; 42-4001(2), (12).  On May 8, 2006, Governor Napolitano signed SB 1170 which permanently repealed Arizona’s state estate tax. |  |
| Arkansas  None | Tax is tied to federal state death tax credit.  AR ST § 26-59-103; 26-59-106; 26-59-109, as amended March, 2003. |  |
| California  None | Tax is tied to federal state death tax credit. CA REV & TAX §§ 13302; 13411. |  |
| Colorado  None | Tax is tied to federal state death tax credit. CO ST §§ 39-23.5-103; 39-23.5-102. |  |
| Connecticut  Separate Estate Tax | On October 31, 2017, the Connecticut Governor signed the 2018-2019 budget which increased the exemption for the Connecticut state estate and gift tax to $2,600,000 in 2018, to $3,600,000 in 2019, and to the federal estate and gift tax exemption in 2020.  On May 31, 2018, Connecticut changed its estate tax law to extend the phase-in of the exemption to 2023 to reflect the increase in the federal exemption to $10 million indexed for inflation in the 2017 Tax Act. The exemption will be phased in as follows:  2019: $3.6 million  2020: $5.1 million  2021: $7.1 million  2022: $9.1 million:  2023: federal exemption for deaths on or after January 1, 2023.  Beginning in 2019, the cap on the Connecticut state estate and gift tax is reduced from $20 million to $15 million (which represents the tax due on a Connecticut estate of approximately $129 million). | $7,100,000 |
| Delaware  None | On July 2, 2017, the Governor signed HB 16 which sunsets the Delaware Estate Tax on December 31, 2017. |  |
| District of Columbia  Pick-up Only | DC Bill B22-0685 was introduced in the DC City Council on February 8, 2018. This proposal cut the DC threshold to $5.6 million adjusted for inflation retroactive to January 1, 2018. This change was enacted by the DC City Council on September 5, 2018 as part of the Budget Support Act.  In August 2020, the DC City Council enacted the “Estate Tax Adjustment Amendment Act of 2020, which reduces the DC threshold to $4 million in 2021 and which will be adjusted for inflation beginning in 2022.  No separate QTIP election. | $4,000,000 |
| Florida  None | Tax is tied to federal state death tax credit.  FL ST § 198.02; FL CONST. Art. VII, Sec. 5 |  |
| Georgia  None | Effective July 1, 2014, the Georgia estate tax was repealed. See § 48-12-1. |  |
| Hawaii  Modified Pick-up Tax | On May 2, 2012, the Hawaii legislature passed HB 2328 which conforms the Hawaii estate tax exemption to the federal estate tax exemption for decedents dying after January 25, 2012.  On June 7, 2018, the governor signed SB 2821, which amended HI ST § 236E-6 to reduce the Hawaiian exemption, effective January 1, 2018, to $5,000,000 indexed for inflation.  The Hawaii Department of Taxation released Announcement 2018-13 on September 4, 2018 in which it announced that the exemption will remain at the amount available to decedents dying during 2017.  In response to calls from practitioners, the Hawaii Department of Taxation indicated that was not going to adjust the exemption for inflation in 2019.  Effective January 1, 2020, Hawaii increased the rate of its state estate tax on estates valued at over $10,000,000 to 20 percent. See Act No. 3 (April 4, 2019). | $5,490,000 |
| Idaho  None | Tax is tied to federal state death tax credit.  ID ST §§ 14-403; 14-402; 63-3004 (as amended Mar. 2002). |  |
| Illinois  Modified Pick-up Only | On January 13, 2011, Governor Quinn signed Public Act 096-1496 which increased Illinois’ individual and corporate income tax rates. Included in the Act was the reinstatement of Illinois’ estate tax as of January 1, 2011 with a $2 million exemption.  Senate Bill 397 passed both the Illinois House and Senate as part of the tax package for Sears and CME on December 13, 2011. It increased the exemption to $3.5 million for 2012 and $4 million for 2013 and beyond. Governor Quinn signed the legislation on December 16, 2011.    Illinois permits a separate state QTIP election, effective September 8, 2009. 35 ILCS 405/2(b-1). | $4,000,000 |
| Indiana  None | Pick-up tax is tied to federal state death tax credit.  IN ST §§ 6-4.1-11-2; 6-4.1-1-4.  On May 11, 2013, Governor Pence signed HB 1001 which repealed Indiana’s inheritance tax retroactively to January 1, 2013. This replaced Indiana’s prior law enacted in 2012 which phased out Indiana’s inheritance tax over nine years beginning in 2013 and ending on December 31, 2021 and increased the inheritance tax exemption amounts retroactive to January 1, 2012 | . |
| Iowa  Inheritance Tax | Pick-up tax is tied to federal state death tax credit. IA ST § 451.2; 451.13.  Effective July 1, 2010, Iowa specifically reenacted its pick-up estate tax for decedents dying after December 31, 2010. Iowa Senate File 2380, reenacting IA ST § 451.2.  Iowa has a separate inheritance tax on transfers to others than lineal ascendants and descendants.  On June 16, 2021, the governor signed SF 619 which, among other tax law changes, reduces the inheritance tax rates by twenty percent each year beginning January 1, 2021 through December 31, 2024 and results in the repeal of the inheritance tax as of January 1, 2025. |  |
| Kansas  None | For decedents dying on or after January 1, 2007 and through December 31, 2009, Kansas had enacted a separate stand-alone estate tax. KS ST § 79-15, 203 |  |
| Kentucky  Inheritance Tax | Pick-up tax is tied to federal state death tax credit. KY ST § 140.130.  Kentucky has not decoupled but has a separate inheritance tax and recognizes by administrative pronouncement a separate state QTIP election. |  |
| Louisiana  None | Pick-up tax is tied to federal state death tax credit. LA R.S. §§ 47:2431; 47:2432; 47:2434. |  |
| Maine  Pick-up Only | For decedents dying after December 31, 2002, pick-up tax was frozen at pre-EGTRRA federal state death tax credit, and imposed on estates exceeding applicable exclusion amount in effect on December 31, 2000 (including scheduled increases under pre-EGTRRA law) (L.D. 1319; March 27, 2003).  On June 20, 2011, Maine's governor signed Public Law Chapter 380 into law, which increased the Maine estate tax exemption to $2 million in 2013 and beyond. The rates were also changed, effective January 1, 2013, to 0% for Maine estates up to $2 million, 8% for Maine estates between $2 million and $5 million, 10 % between $ 5 million and $8 million and 12% for the excess over $8 million.  On June 30, 2015, the Maine legislature overrode the Governor’s veto of LD 1019, the budget bill for fiscal years 2016 and 2017. As part of the law, the Maine Exemption was tagged to the federal exemption for decedents dying on or after January 1, 2016.  The tax rates are:  8% on the first $3 million above the Maine Exemption;  10% on the next $3 million above the Maine Exemption; and  !2% on all amounts above $6 million above the Maine Exemption.  The new legislation did not include portability as part of the Maine Estate Tax.  On September 12, 2018, LP1655 became law without the Governor’s signature. The new law amends M.R.S. Title 36, Section 4102 and Section 4119 to make the Maine exemption $5,600,000 adjusted for inflation for decedents dying on and after January 1, 2018.  For estates of decedents dying after December 31, 2002, Sec. 2058 deduction is ignored in computing Maine tax and a separate state QTIP election is permitted. M.R.S. Title 36, Sec. 4062.    Maine also subjects real or tangible property located in Maine that is transferred to a trust, limited liability company or other pass-through entity to tax in a non-resident’s estate. M.R.S. Title 36, Sec. 4064. | $5,870,000 |
| Maryland  Pick-up Tax  Inheritance Tax | On May 15, 2014, Governor O’Malley signed HB 739 which repealed and reenacted MD TAX GENERAL §§ 7-305, 7-309(a), and 7-309(b) to do the following:   1. Increased the threshold for the Maryland estate tax to $1.5 million in 2015, $2 million in 2016, $3 million in 2017, and $4 million in 2018. For 2019 and beyond, the Maryland threshold will equal the federal applicable exclusion amount. 2. Continued to limit the amount of the federal credit used to calculate the Maryland estate tax to 16% of the amount by which the decedent’s taxable estate exceeds the Maryland threshold unless the Section 2011 federal state death tax credit is then in effect. 3. Continued to ignore the federal deduction for state death taxes under Sec. 2058 in computing Maryland estate tax, thus eliminating a circular computation. 4. Permitted a state QTIP election.   On April 5, 2018, HB 0308 became law. The new law provides that for 2019 and thereafter, the Maryland threshold will be capped at the fixed amount of $5 million rather than being equal to the inflation-adjusted federal exemption as provided under prior law.  The new law also provides for the portability of the unused predeceased spouse’s Maryland exemption amount to the surviving spouse beginning in 2019. | $5,000,000 |
| Massachusetts  Pick-up Only | For decedents dying in 2002, pick-up tax is tied to federal state death tax credit. MA ST 65C §§ 2A.  For decedents dying on or after January 1, 2003, pick-up tax is frozen at federal state death tax credit in effect on December 31, 2000. MA ST 65C §§ 2A(a), as amended July 2002.  Tax imposed on estates exceeding applicable exclusion amount in effect on December 31, 2000 (including scheduled increases under pre-EGTRRA law), even if that amount is below EGTRRA applicable exclusion amount.  See, Taxpayer Advisory Bulletin (Dec. 2002), DOR Directive 03-02, Mass. Guide to Estate Taxes (2003) and TIR 02-18 published by Mass. Dept. of Rev.  Massachusetts Department of Revenue has issued directive, pursuant to which separate Massachusetts QTIP election can be made when applying state’s new estate tax based upon pre-EGTRRA federal state death tax credit. | $1,000,000 |
| Michigan  None | Tax is tied to federal state death tax credit.  MI ST §§ 205.232; 205.256 |  |
| Minnesota  Pick-up Only | Tax frozen at federal state death tax credit in effect on December 31, 2000, clarifying statute passed May 2002.  Tax imposed on estates exceeding federal applicable exclusion amount in effect on December 31, 2000 (including scheduled increases under pre-EGTRRA law), even if that amount is below EGTRRA applicable exclusion amount.  MN ST §§ 291.005; 291.03; instructions for MN Estate Tax Return; MN Revenue Notice 02-16.  Separate state QTIP election permitted.  On May 30, 2017, the governor signed the budget bill, H.F. No. 1 which increased the Minnesota estate tax exemption for 2017 from $1,800,000 to $2,100,000 retroactively, and increases the exemption to $2,400,000 in 2018, $2,700,000 in 2019, and $3,000,000 for 2020 and thereafter.  A provision enacted in 2013 to impose an estate tax on non-residents who own an interest in a pass-through entity which in turn owned real or personal property in Minnesota was amended in 2014 to exclude certain publicly traded entities. It still applies to entities taxed as partnerships or S Corporations that own closely held businesses, farms, and cabins. | $3,000,000 |
| Mississippi  None | Tax is tied to federal state death tax credit.  MS ST § 27-9-5. |  |
| Missouri  None | Tax is tied to federal state death tax credit.  MO ST §§ 145.011; 145.091. |  |
| Montana  None | Tax is tied to federal state death tax credit.  MT ST § 72-16-904; 72-16-905. |  |
| Nebraska  County Inheritance Tax | Nebraska through 2006 imposed a pick-up tax at the state level. Counties impose and collect a separate inheritance tax.  NEB REV ST § 77-2101.01(1). |  |
| Nevada  None | Tax is tied to federal state death tax credit.  NV ST Title 32 §§ 375A.025; 375A.100. |  |
| New Hampshire  None | Tax is tied to federal state death tax credit.  NH ST §§ 87:1; 87:7. |  |
| New Jersey  Inheritance Tax | On October 14, Governor Christie signed Assembly Bill A-12 which was the tax bill accompanying Assembly Bill A-10 which revised the funding for the state’s Transportation Fund. Under this law, the Pick-Up Tax had a $2 million exemption in 2017 and was eliminated as of January 1, 2018. The new law also eliminated the tax on New Jersey real and tangible property of a non-resident decedent.  The repeal of the pick-up tax did not apply to the separate New Jersey inheritance tax. | . |
| New Mexico  None | Tax is tied to federal state death tax credit.  NM ST §§ 7-7-2; 7-7-3. |  |
| New York  Pick-up Only | The Executive Budget of 2014-2015 which was signed by Governor Cuomo on March 31, 2014 made substantial changes to New York’s estate tax.  The New York estate tax exemption which was $1,000,000 through March 31, 2014 was increased as follows:  April 1, 2014 to March 31, 2015 -- $2,062,500  April 1, 2015 to March 31, 2016 -- $3,125,000  April 1, 2016 to March 31, 2017 -- $4,187,500  April 1, 2017 to December 31, 2018 -- $5,250,000  As of January 1, 2019, the New York estate tax exemption amount will be the same as the federal estate tax applicable exclusion amount **prior** to the 2017 Tax Act which is $5,000,000 adjusted for inflation.  The maximum rate of tax will continue to be 16%.  Taxable gifts within three years of death between April 1, 2014 and December 31, 2018 will be added back to a decedent’s estate for purposes of calculating the New York tax.  The New York estate tax is a cliff tax. If the value of the estate is more than 105% of the then current exemption, the exemption will not be available.  On April 1, 2015, as part of 2015-2016 Executive Budget, New York enacted changes to the New York Estate Tax. New York first clarified that the new rate schedule enacted in 2014 applies to all decedents dying after April 1, 2014. Previously, the rate schedule only applied through March 31, 2015. New York then modified the three year gift add-back provision to make it clear that the gift add-back does not apply to any individuals dying on or after January 1, 2019. Previously, the gift add-back provision did not apply to gifts made on or after January 1, 2019.  New York continues not to permit portability for New York estates and no separate state QTIP election is allowed when portability is elected on a federal return. | $5,930,000 |
| North Carolina  None | On July 23, 2013, the Governor signed HB 998 which repealed the North Carolina estate tax retroactively to January 1, 2013. |  |
| North Dakota  None | Tax is tied to federal state death tax credit.  ND ST § 57-37.1-04 |  |
| Ohio  None | Governor Taft signed the budget bill, 2005 HB 66, repealing the Ohio estate (sponge) tax prospectively and granting credit for it retroactively. This was effective June 30, 2005 and killed the sponge tax.  On June 30, 2011, Governor Kasich signed HB 153, the biannual budget bill, which contained a repeal of the Ohio state estate tax effective January 1, 2013. |  |
| Oklahoma  None | Tax is tied to federal state death tax credit.  OK ST Title 68 § 804  The separate estate tax was phased out as of January 1, 2010. |  |
| Oregon  Separate Estate Tax | On June 28, 2011, Oregon’s governor signed HB 2541 which replaced Oregon’s pick-up tax with a stand-alone estate tax effective January 1, 2012.  The new tax has a $1 million threshold with rates increasing from ten percent to sixteen percent between $1 million and $9.5 million.  Determination of the estate for Oregon estate tax purposes is based upon the federal taxable estate with adjustments. | $1,000,000 |
| Pennsylvania  Inheritance Tax | Tax is tied to the federal state death tax credit to the extent that the available federal state death tax credit exceeds the state inheritance tax.  PA ST T. 72 P.S. § 9117 amended December 23, 2003.  Pennsylvania had decoupled its pick-up tax in 2002, but has now recoupled retroactively. The recoupling does not affect the Pennsylvania inheritance tax which is independent of the federal state death tax credit.  Pennsylvania recognizes a state QTIP election. |  |
| Rhode Island  Pick-up Only | Tax frozen at federal state death tax credit in effect on January 1, 2001, with certain adjustments (see below). RI ST § 44-22-1.1.  Rhode Island recognized a separate state QTIP election in the State’s Tax Division Ruling Request No. 2003-03.  Rhode Island's Governor signed into law HB 5983 on June 30, 2009, effective for deaths occurring on or after January 1, 2010, an increase in the amount exempt from Rhode Island estate tax from $675,000, to $850,000, with annual adjustments beginning for deaths occurring on or after January 1, 2011 based on "the percentage of increase in the Consumer Price Index for all Urban Consumers (CPI-U). . . rounded up to the nearest five dollar ($5.00) increment." RI ST § 44-22-1.1.  On June 19, 2014, the Rhode Island Governor approved changes to the Rhode Island Estate Tax by increasing the exemption to $1,500,000 indexed for inflation in 2015 and eliminating the cliff tax. | $1,595,156 |
| South Carolina  None | Tax is tied to federal state death tax credit.  SC ST §§ 12-16-510; 12-16-20 and 12-6-40, amended in 2002. |  |
| South Dakota  None | Tax was permanently repealed in 2014 with repeal of all of SDCL § 10-40A, effective July 1, 2014. |  |
| Tennessee  None | Pick-up tax is tied to federal state death tax credit.  TN ST §§ 67-8-202; 67-8-203.  Tennessee had a separate inheritance tax which was phased out as of January 1, 2016. |  |
| Texas  None | Tax was permanently repealed effective as of September 15, 2015 when Chapter 211 of the Texas Tax Code was repealed. Prior to September 15, 2015, the tax was tied to the federal state death tax credit. |  |
| Utah  None | Tax is tied to federal state death tax credit.  UT ST § 59-11-102; 59-11-103. |  |
| Vermont  Modified Pick-up | In 2010, Vermont increased the estate tax exemption threshold from $2,000,000 to $2,750,000 for decedents dying on or after January 1, 2011. As of January 1, 2012, the exclusion equaled the federal estate tax applicable exclusion amount, so long as the FET exclusion was not less than $2,000,000 and not more than $3,500,000. VT ST T. 32 § 7442a.  On June 18, 2019, Vermont enacted H. 541 which increased the Vermont estate tax exemption to $4,250,000 in 2020 and $5,000,000 in 2021 and thereafter.  No separate state QTIP election permitted.  Vermont does not permit portability of its estate tax exemption. | $5,000,000 |
| Virginia  None | Tax is tied to federal state death tax credit.  VA ST §§ 58.1-901; 58.1-902.  The Virginia tax was repealed effective July 1, 2007. Previously, the tax was frozen at federal state death tax credit in effect on January 1, 1978. Tax was imposed only on estates exceeding EGTRRA federal applicable exclusion amount. VA ST §§ 58.1-901; 58.1-902. |  |
| Washington  Separate Estate Tax | LEGISLATIVE FRAMEWORK. On February 3, 2005, the Washington State Supreme Court unanimously held that Washington’s state death tax was unconstitutional. The tax was tied to the current federal state death tax credit, thus reducing the tax for the years 2002 - 2004 and eliminating it for the years 2005 - 2010. Hemphill v. State Department of Revenue 2005 WL 240940 (Wash. 2005).  In response to Hemphill, the Washington State Senate on April 19 and the Washington House on April 22, 2005, by narrow majorities, passed a stand-alone state estate tax with rates ranging from 10% to 19%, a $1.5 million exemption in 2005 and $2 million thereafter, and a deduction for farms for which a Sec. 2032A election could have been taken (regardless of whether the election is made). The Governor signed the legislation.  WA ST §§ 83.100.040; 83.100.020.  Washington voters defeated a referendum to repeal the Washington estate tax in the November 2006 elections.  On June 14, 2013, Governor Inslee signed HB 2075 which closed an exemption for marital trusts retroactively immediately prior to when the Department of Revenue was about to start issuing refund checks, created a deduction for up to $2.5 million for certain family owned businesses and indexes the $2 million Washington state death tax threshold for inflation.  SEPARATE QTIP ELECTION. Washington permits a separate state QTIP election. WA ST §83.100.047.  NO INDEXING FOR INLFATION IN 2019. Washington State was supposed to index the exemption annually for inflation. However, this was not done for 2019.  On December 18, 2018, the Department of Revenue sent an email stating that pursuant to Revised Code of Washington (RCW) 83.100, the Department must adjust the Washington applicable estate tax exclusion amount annually using the Seattle-Tacoma-Bremerton metropolitan area October consumer price index (Seattle CPI).  As of January 1, 2018, the US Bureau of Labor and Statistics (USBLS) no longer calculates the consumer price index for the Seattle-Tacoma-Bremerton metropolitan area. Instead, the USBLS will calculate the consumer price index for the Seattle-Tacoma-Bellevue Core Based Statistical Area for the Puget Sound region.  As a result of these changes, the definition of “consumer price index” in RCW 83.100.020(1)(b) does not match with the current CPI measure calculated by the USBLS.  The Department is using the last CPI figure for the Seattle CPI. This resulted in no increase in the applicable exclusion amount for 2019 and 2020. | $2,193,000 |
| West Virginia  None | Tax is tied to federal state death tax credit.  WV § 11-11-3. |  |
| Wisconsin  None | Tax is tied to federal state death tax credit. WI ST § 72.01(11m).  For deaths occurring after September 30, 2002, and before January 1, 2008, tax was frozen at federal state death tax credit in effect on December 31, 2000 and was imposed on estates exceeding federal applicable exclusion amount in effect on December 31, 2000 ($675,000), not including scheduled increases under pre-EGTRRA law, even though that amount is below the lowest EGTRRA applicable exclusion amount. Thereafter, tax imposed only on estates exceeding EGTRRA federal applicable exclusion amount.  WI ST §§ 72.01; 72.02, amended in 2001; WI Dept. of Revenue website.  On April 15, 2004, the Wisconsin governor signed 2003 Wis. Act 258, which provided that Wisconsin will not impose an estate tax with respect to the intangible personal property of a non-resident decedent that has a taxable situs in Wisconsin even if the non-resident’s state of domicile does not impose a death tax. Previously, Wisconsin would impose an estate tax with respect to the intangible personal property of a non-resident decedent that had a taxable situs in Wisconsin if the state of domicile of the non-resident had no state death tax. |  |
| Wyoming  None | Tax is tied to federal state death tax credit.  WY ST §§ 39-19-103; 39-19-104. |  |

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1. These materials are based on materials prepared by Andrea Chomakos, W. Birch Douglas, III, Charles D. Fox IV, Kristen Hager, Meghan Gehr Hubbard, Sean Murphy, Stephen W. Murphy, and William I. Sanderson of McGuireWoods LLP. [↑](#footnote-ref-1)