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Probate and Trust Law Section Newsletter

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Report of the Chair

By MARGARET GALLAGHER THOMPSON
COZEN O'CONNOR

It is truly humbling to take over the reins as Chair of the Probate & Trust Law Section of the Philadelphia Bar Association. The past accomplishments of this Section, and this Bar Association, could be intimidating to a new Chair. The Section's accomplishments, however, rest and depend, not on the Officers, but on the work of the Section's substantive Committees and the dedication of the Executive Committee members. The year 2009 is no exception. We are off to a strong start.

At the March quarterly meeting, the Education Committee, led by Aaron Fox, served up an informative and timely program on nonjudicial settlement agreements under the Pennsylvania Trust Act. In addition, Judge Lazarus spoke briefly and challenged Section members to take on pro bono cases in our practice area, specifically the "tangled title" cases. Contact Philadelphia VIP to help at www.phillyvip.org.

The Elder Law Committee, led by Keelin Barry and Rise Newman, is working with Judge Lazarus to complete a guardianship manual, which will inform and guide practitioners and the public who may be called upon to serve as counsel or guardians for incapacitated persons.

The Legislative Committee, led by Kathleen Stephenson, is reviewing pending and planned legislation, including the Uniform Prudent Management of Institutional Funds Act and the proposed Pennsylvania Assisted Reproductive Technologies Act. In addition, Jay Foster, our Legislative Liaison to the Philadelphia Bar Association, provides monthly updates on the activity of the Pennsylvania legislature on the Probate Section listserv.

The Orphans' Court Litigation & Dispute Resolution Committee, led by Tim Holman, is examining a variety of timely issues, including metadata in E-discovery, engagement letters, and discovery protocols.

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Inside this Issue...

Too Good To Be True? The Process of Manager Due Diligence

By BEN ALIMANKSY
THE GLENMEDE TRUST COMPANY

NOTE: *In light of volatility in the market and the Madoff scandal, the new head of Glenmede's Manager Alliances Program (MAP), Ben Alimansky, discusses Glenmede's approach toward manager due diligence.*

The importance of doing thorough due diligence on investment managers is a critical aspect of a wealth management organization. There are in fact two different perspectives investors should take when analyzing an investment manager.

This first perspective, investment due diligence, examines the fund's investment strategy and the skill of its team. It should involve detailed discussions with the fund manager to understand the underlying processes the manager employs to find attractive investment ideas.

The second perspective looks at the investment manager as a business. Mutual funds, hedge funds and separate account strategies are businesses in which talented professionals practice their craft. The success or perhaps more importantly, resistance to failure, of the fund or strategy depends on its success as a business.

In order to give the reader a sense for the due diligence process, below is a sample list of ten "topics" which should be covered in the interview. By all means there is no perfect checklist or guideline which will apply to all types of investment managers under all conditions, however this can be considered a starting point.

1. Investment Strategy Thesis. Simply put, how the manager makes money should be clearly articulated and straightforward to understand. While not all investment strategies are obvious – the thesis of the approach should be intuitive. In addition, one should clearly understand the circumstances under which the strategy will make and, importantly, lose money. Note that, with the exception of holding US Treasury securities to maturity, no strategy is immune to market movement.

2. Investment Team. An investment strategy is the result of talented individuals practic-

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Report of the Chair, continued

The Publications Committee, led by Bob Louis and David Ruben, has produced this first Newsletter of the year. I think you will agree that the Section Newsletter is an important publication in our practice area, known for its succinct coverage of the difficult legal and ethical issues we face.

The Rules and Practice Committee, led by Bernice Koplin, recently completed work on an Account Checklist for Agents acting under Powers of Attorney, which is now available on the Philadelphia Courts website. For this and other forms and information, visit www.courts.phila.gov. (Click, Publications, then Forms, then scroll down to "Orphans' Court Division"). In addition the Committee is working on revisions to certain local Orphans' Court rules to clarify procedures.

The Tax Committee, led by Terry Kline and Don DiCarlo, has a line up of timely topics and experienced speakers for this year's meetings. On April 7, Mark Blaskey addressed the committee on tax issues related to estate planning with closely-held business interests.

Last but not least, in a time when some may wonder where we will find the next generation of Trusts & Estates attorneys, this year we have seven "Young Lawyers" serving as Chairs of a Section Committee or as elected members of the Section's Executive Committee. (I will not mention any names as some of us may consider ourselves "young lawyers" notwithstanding our chronological ages.)

I could go on if space permitted. Instead, however, I invite you to join a Committee (email me at mthompson@cozen.com), visit the Section page at the Philadelphia Bar Association website, www.philadelphiabar.org., and use the Section Listserv (PROBATE_AND_TRUST_PBA@LISTSERVE.PHILABAR.ORG).

Best wishes for a busy and fulfilling spring.

Manager Due Diligence, continued

ing their craft and therefore is dependent on all the dynamics of human behavior in organizations. Besides the strategy itself, the skill of the team must be carefully evaluated. In addition, team dynamics, compensation, and overall stability are critical features and should be understood and monitored.

3. Reference and Background Checks. Along with understanding strategy and team, investors should independently perform reference and background checks on key individuals. The point here is to verify basic personnel information and look for any legal or court actions – which may be a sign of more significant problems. Speak with people who worked closely with the principals and know the way they generate investment ideas, have a sense for their risk taking and risk management abilities, and know their capability for managing a team and business.

4. Track Record. A strategy's track record provides measurable evidence of the investment thesis and team's abilities. While past performance should never be taken as evidence of future performance, it provides additional evidence for how the strategy has behaved and may react in the future. In addition, and importantly, careful analysis may point to strengths and weaknesses which may repeat themselves in the future. Being aware of these allows the investor to set expectations.

5. Fund Terms. Think about whether the fund's terms are fair and reasonable and commensurate with the strategy. Consider: a) management and performance fees. Do (1-3, above) justify these fees? b) what are liquidity provisions (lock up, ability to suspend redemptions, fee for early redemption)? Are these fair for the investment approach? This is less of an issue with mutual funds and separate accounts but more an issue with partnerships. However, does a strategy which invests in liquid securities, such as large cap equities, deserve a two year lock up? Some strategies do deserve to control the liquidity of capital – such as those in less liquid markets (distressed debt or direct lending).

6. Risk Management. Every investment strategy must have a risk management strategy associated with it. Its purpose is to govern the investment function with respect to the market. Investors should evaluate the soundness of the risk management policy and, similar to the investment strategy itself, it should be intuitive.

7. Service Providers. Especially important in the context of partnerships such as hedge funds, investors should understand who the fund's accountant, administrator, custodian, and prime broker are.

8. Trade Execution. The investment function cannot exist within a vacuum. Trades must be executed on behalf of the client. As part of due diligence, investors should have a sense for how this occurs – for example, who the counterparties are (e.g., execution brokers, prime brokers).

9. Compliance. How does the fund management company handle internal compliance? Does it have a compliance officer to provide oversight and what does that person do on a regular basis? If there is no dedicated person, does it leverage an outside consultant to provide oversight?

10. Transparency. Along with other operational concerns, investors should feel comfortable with the degree of transparency provided by any investment strategy. This is important, whether investing in a mutual fund or hedge fund, not only to give comfort that the manager is doing what they say they will do, but to give the investor confidence – especially during challenging market environments – to stick with the strategy long-term, or to decide that the strategy is no longer appropriate.

In conclusion, investors need to ask themselves, is it too good to be true? Be suspicious of returns that seem unusually good during periods of market dislocation (both positive and negative). As discussed previously, whether a strategy is directional (deliberately has exposure to the market) or exploits an "arbitrage" (looks for momentary mispricings of securities and hedges out most market exposure only to capture the mispricing) it will exhibit some sensitivity to market conditions.

These steps are only a sampling of various issues which investors should consider when doing due diligence on investment strategies and should be part of a comprehensive research and asset allocation investment process.

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Glenmede researches and identifies talented public securities investment managers through its Manager Alliances Program (MAP).

"How Bad is It?" Views from America's Oldest Auction and Appraisal Firm

By DAVID M. WEISS
SAMUEL T. FREEMAN & CO.

Recent articles in two of the leading international art industry publications recount the current economic climate's affect on fine art auctioneers, collectors, dealers, art fair organizers and even museums with the headlines: "Sotheby's see 87% fall in annual profits" (Antiques Trade Gazette, March 1, 2009) and "Silver Linings" (Art & Auction magazine, April 2009).

Just below these headlines, the authors of these articles report… "Final quarter sales slump means another 15% staff cuts," and… "Prices are coming down, masterpieces are coming to light and collectors are coming to realize that sunny days still lie ahead." While these headlines – conflicting prima facie - and the accompanying stories may appear to be the ultimate metaphor for the 'glass half empty-half full,' they clearly underscore that the art market at large - and by extension the industries and individuals who support it - is in the midst of a profound period of change. Widely reported price decreases in many areas of the market have resulted in innumerable concerns, questions, misunderstandings, and ultimately inertia, in many cases, amongst veteran art collectors, estate executors and especially private individuals to whom individual works, or entire collections, have been bequeathed.

As an appraiser and auctioneer working in the fine art and antique trade for two decades, I believe a number of issues about the economy as they pertain to the art market, particularly as such issues directly affect the Estate and Trust legal profession, need to be clarified.

First, the current downturn in the economy and the art market is not without precedent. A similar decline in prices occurred in 1991. As in any other active, fluid market in which commodities are bought, sold and traded, the art and antique market is subject to fluctuations and price appreciation and/or depreciation.

Second, while the art market drop is hardly unexpected, coming on the heels of massive losses in the real estate and employment markets and in an environment where 'toxic assets' has become this decade's catchphrase, it was also likely overdue. Not dissimilar to the 'irrational exuberance' that catapulted the stock market to record highs in the late 1990s, certain areas of the art market have experienced unprecedented growth in recent years, including, but not limited to, the Contemporary market, along with the Russian, Chinese and Indian markets. Much has been written about this decade's meteoric rise in prices in these markets, with a good deal of the price appreciation in contemporary art circles occurring because of speculators and 'investors' buying to resell (see 'Flip This House'), and much of the price hikes in 'rediscovered' international markets being propelled by newly minted collectors 'buying back' bits of their country's once-neglected heritage. Using these examples, however, it bears noting that those sectors of the market that quickly rose the highest are, not surprisingly, the ones that have been hit the hardest. Other sectors of the art and antiques market that did not experience such price spikes have not experienced such precipitous drops.

Third, what we as appraisers and auctioneers perceive as an almost utter gloom and doom amongst (potential) art and antique sellers, dealers and the public at large, is a bit overblown. While such a proclamation may sniff of this writer's own slightly biased, industry insider's wishful thinking, it is not without merit. Just last month Christie's had great success in selling the collection of the late French designer Yves Saint Laurent, with the over $470,000,000 realized exceeding all pre-auction expectations. Closer to home, Freeman's most recent auction of Asian Arts featured, amongst other star lots, a jade estimated to sell for $6,000-8,000 that brought $41,800, a jade brush washer expected to realize $10,000-15,000 that sold for $79,000, and a Chinese 20th century painting that carried a $3,000-5,000 estimate and hammered down for $115,000. While the YSL results may be, at least in part, attributable to the notoriety typically associated

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How Bad is It, continued

with important single-owner sales, and the Freeman's Asian auction results pointing to continued (albeit slightly lessened) strength in that market, other areas of collecting have experienced a recent renaissance, including Old Master paintings (forgive the art pun), as art buyers, following many of their stock market peers, experience a 'flight to quality.'

Fourth, misperceptions about the value, worth and rarity of some art and antiques still pervade the market, as they did when the market was strongest. Some areas of the market, including much of the market for traditional furniture (often referred to somewhat disparagingly in the trade as the 'brown wood' market) remain soft, as they had been, even when prices for many other antiques and art continued to rise. Not every artwork and antique was 'priceless' during the market's rise: even at the market's apex, many a disappointed auction consignor could be heard to ask with incredulity,… "is that all?" when told of the true market value of their limited edition, 'rare' Salvador Dali lithograph. Conversely, not every artwork and antique has lost its value in the current market: many a consignor remains pleasantly surprised when an item they were considering throwing away draws multiple auction bidders and a strong price (e.g. the example of a badly damaged antique Oriental carpet with a large section rotted away by an overly watered house plant under which it lay selling for over $20,000 recently at Freeman's). The lesson here is that many artworks and antiques that a client owns have not been great sellers for many years (19th century French Barbizon School paintings are another such example). Such items were not selling terribly well even at the height of the market. Clients who own similar examples and are considering selling but who openly state a preference to 'hold off until the economy turns around' inaccurately presume that just a year or two prior, all art and antiques were in high demand.

Fifth, and lastly, while the impressive rise in prices has not continued unabated for works by a number of Pennsylvania artists more familiar to denizens of our local art market (including Harry Bertoia and Fern Coppedge, to name two), such artworks remain solidly in demand by collectors perched on the sidelines. To paraphrase a still commonly overheard auction room adage: "I couldn't buy a thing today; I got outbid on every lot in which I had interest." What was tried and true in the art/antiques market before the stock and housing markets collapsed remains a truism in our industry today: fine items that are excellent examples of their type, in good condition, sensibly priced (but not at 'fire sale' levels) and from good private collections remain sought after. As auctioneers, navigating the fine line between meeting a seller's expectations and potential bidders hopes (to clarify: our industry represents the seller's interests) has never been easy, and during uncertain economic times, it becomes more difficult. To wit, sellers are concerned that they will not receive enough money for their possessions, and buyers believe they should not have to pay vast sums for those same possessions (…sounds like a redux of the housing market?). As such, it may be wise to counsel clients who are contemplating the sale of art and antiques, often acquired by inheritance, that contrary to popular sentiment, this is in fact, not a bad time to be selling, and to counsel clients who wish to purchase art and antiques, often to enhance a portfolio with a tangible asset, that while prices are down a bit – more in some areas, less in others – they may not be able to walk away with bargains as they had hoped, whether at an auction, a gallery or a fair. To quote Pierre Berge, Yves Saint Laurent's partner in regard to the YSL sale, "when you offer works of quality, the buyers are there" (Reference: Reuters UK, online).

NEWSLETTER ARTICLES

Would you like to see something in future issues of the Probate and Trust Law Section Newsletter? Then, why don't you write it? If you are interested, please contact the Editor:

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The Superior Court Declines to Interpret Section 5456 of the Probate, Estates and Fiduciaries Code as Extending the Authority to Decline Life Sustaining Medical Treatment to Plenary Guardians of the Person

By JENNIFER DiVETERANO GAYLE, ESQ.
MANNION PRIOR, LLP

In *In re D.L.H. Incapacitated Person,* 2009 Pa. Super. 25, the parents and plenary guardians of their adult child, D.L.H., appealed from the Orphan's Court's order denying their petition to decline life preserving medical treatment on behalf of D.L.H.

D.L.H. is a 50-year-old man who suffered from profound mental retardation since birth and who never executed a legal instrument expressing his desires in regard to life sustaining medical treatment. Appellants were appointed D.L.H.'s plenary guardians in 2002.

In 2007, D.L.H. became ill with aspiration pneumonia and was placed on a mechanical ventilator to assist him in breathing. Appellants attempted to decline medical treatment, claiming that their status as plenary guardians of D.L.H. vested them with the legal authority to make surrogate medical decisions and that mechanical ventilation was not in his best interests. Over their objection, D.L.H.'s doctors placed him on a mechanical ventilator. In response, Appellants filed a "Petition to Grant the Guardians Authority to Exercise the Powers of a Health Care Agent on Behalf of the Incapacitated."

The trial court held that Appellants failed to meet the statutory requirements necessary to become D.L.H.'s "health care agent" under the Health Care Agents and Representatives Act, 20 Pa. C.S.A. §§ 5451-5471, and thus, that they did not have the authority to refuse life sustaining medical treatment on his behalf. The Superior Court affirmed the trial court's order through different reasoning.

The Superior Court began its analysis by discussing the fundamental distinction that exists at common law between an agent and a guardian. An agent is subjected to the power of the principal and has a duty to carry out the principal's expressed wishes. By contrast, a guardian, acting as an officer of the court, theoretically must take action that is in the best interest of the incapacitated person and, through judicial review, is subjected to the court's control regarding the ward. The authority granted to a health care agent in Section 5456 is more consistent with the creation of a common law agency relationship and the duty of the agent to comply with the instructions received from the principal. Further, under 20 Pa. C.S.A. §§ 5456(a) and 5461(c) the health care agent has the express statutory authority to object to life sustaining medical procedures on behalf of a principal, where the principal has neither an end-stage medical condition nor is permanently unconscious.

Thus, the authority to make these health care decisions on behalf of a principal is specifically designated to a health care agent. In contrast, the authority to refuse life sustaining medical treatment to an individual who has neither an end-stage medical condition nor is permanently unconscious is not specifically granted to plenary guardians under 20 Pa. C.S.A. § 5521(a). Therefore, the Superior Court concluded that Appellants' status of plenary guardians, standing alone, does not confer them with the blanket authority to exercise the power of a health care agent.

Even assuming that the Orphans' Court could specially grant a guardian the power to decline medical treatment for an incompetent who does not have an end-stage medical illness nor is in a permanent vegetative state, the Superior Court concluded that the guardian would first have to petition the court for such power, and then prove by clear and convincing evidence that refusing medical treatment would be in the best interest of the incapacitated person before exercising that power. In determining whether death would be in the incapacitated person's best interest, a court should only consider the best interests of the incapacitated person, not the interest or convenience of the parents, guardians or society in general. Additionally, in order to establish that death is in the incapacitated person's best interest, a guardian, at minimum, must prove reliable medical expert testimony documenting the incapacitated person's severe, permanent medical condition and current state of physical/psychological

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Beil Estate

By BENJAMIN K. RODGERS
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In *Beil Estate*, the decedent designated his wife as the sole beneficiary of a life insurance policy he held on his own life. *Beil Estate*, 29-3 Fiduciary Reporter 2d, Cumberland County 2008. The policy did not contain a contingent beneficiary designation. Approximately two years after he purchased the policy and made the beneficiary designation, the decedent and his wife were divorced. The decedent died approximately five years after the divorce and never changed the beneficiary designation on his policy. The insurance company declined to pay the proceeds, pursuant to 20 Pa. C.S. §6111.2, to decedent's former wife, who contended that decedent wished her to receive 100% of the proceeds notwithstanding the divorce.

A presumption is established under 20 Pa. C.S. §6111.2 that upon divorce, ex-spouses intend to revoke all life insurance beneficiary designations in favor of the former spouse. The court explained that, as provided in the statute, this presumption may be overridden if it appears from the wording of the designation, a court order or a written contract between the decedent and former spouse that the designation was intended to survive the divorce.

The court then briefly discussed a constitutionality argument raised by the petitioner but was unable to address constitutional issues because certain procedural requirements had not been met and because the court was guided by the "canon of constitutional avoidance" in construing the statute, which constrained the court to avoid constitutional questions and to "interpret the statute in a way which allows at least the reasonable prospect of honoring the contractual intent of the insured."

In construing the language of §6111.2, the court concluded that the term "court order" as used in the statute refers only to an order in existence prior to the death of the insured. The court deemed such interpretation to be in furtherance of "the clear legislative intent of Section 6111.2" to require "some documentary or written evidence that the beneficiary designation was intended to survive divorce." Without such evidence, the statute renders the designation ineffective.

The court also noted that there is no further explanation in §6111.2 of what is meant by a "written contract between the person and such former spouse," but concluded that, because the legislature refrained from narrowing the definition in any way, the term should be given the broadest interpretation. Accordingly, the court found that an exchange of emails between the decedent and his former spouse that occurred after the divorce satisfied the requirements of a written contract within the meaning of §6111.2. In the email to his former wife, decedent "made a clear statement with regard to his intention" that she receive the proceeds of the life insurance policy. Decedent's former wife responded by acknowledging that she would receive the proceeds

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In re D.L.H., continued

deterioration and pain. The court should not place any emphasis or the fact that the incapacitated person, prior to receiving medical treatment, suffers from a mental disability or other cognitive deficiency, because this in that individual's natural state of being.

In the absence of any evidence of an incapacitated person's expressions during or prior to treatment, the quality of the medical evidence should be of such a character that a court is convinced that the benefits of prolonging life, as a result of medical treatment, is markedly outweighed by the incurable nature of the incompetent's medical condition and the consistent, recurring degree of pain. A court should be able to conclude, without hesitation, that extending life would amount to an inhumane act that runs so contrary to basic notations of fundamental decency that death furthers the best interests of the incompetent.

The Superior Court expressly limited its holding to the following: "where a life-long incompetent adult has neither an end-stage medical illness nor is in a [permanent vegetative state], and a plenary guardian seeks to decline life preserving medical treatment on behalf of the incompetent, if the plenary guardian fails to establish that death is in the incompetent's best interests, by clear and convincing proof, then the guardian does not have the legal authority to decline life preserving medical treatment on behalf of the incompetent."

ETHICS COLUMN

By PAUL C. HEINTZ
OBERMAYER, REBMANN, MAXWELL & HIPPEL LLP

How does an attorney ethically respond to the inquiry of a client's child, holding the parent's Power of Attorney, who desires to transfer the parent's assets to himself and his siblings to shield the parent's assets from depletion by nursing home expenses?

The attorney must always remember that the client is the one to whom the attorney owes the duty of loyalty. Accordingly, the initial and superficial answer to the child's question is apparent: The attorney cannot counsel the child to, effectively, bankrupt the client or otherwise render the client financially weakened or no longer financially independent. Even the finest children with the purest of motives may later be unwilling or unable to return the gifted funds or apply them for the client's benefit should the need later arise.

As an aside, it has been held that guardians have a duty to pursue and use the ward's assets for his or her benefit prior to seeking governmental assistance, and that Medicaid or Medical Assistance should be the payor of last resort. *Pomroy v. Dept. of Public Welfare,* 750 A.2d 395 (Pa. Cmwlth. 2002); *Wyinegar Estate*, 711 A.2d 492 (Pa. Super. 1998) and *Adler, Incapacitated Person,* 23 Fid. Rep. 2d 340 (Phila. 2003). It would seem the same principle applies to one holding a Power of Attorney.

The tougher question is what to do if, or when, the client makes the same request, perhaps even following up a child's earlier inquiry on his or her behalf confirming the client wants to make massive gifts to the children. Some clients would rather accept the obvious risks of gift-giving to children than allow a nursing home or other group of creditors to end up with the family wealth.

Rule 1.2(d) of the Rules of Professional Conduct makes clear that it is proper for an attorney to counsel a client about the scope and meaning of the law. Accordingly, a complete description of the means by which the wealth transfers may be made and the consequences of doing so is ethical. In fact, a full description of the consequences would even be advisable because it just may end the temptation. A discussion of the Fraudulent Transfer Act concepts and the well known "look back" rules in the Medicaid arena can be quite sobering.

On the other hand, Rule 4.4 suggests that the attorney may cross the line if he or she encourages, or directly or indirectly participates in any transaction that has no substantial purpose other than to delay or burden a third person. Thus, if the attorney has received a call from the client (or child) while the client is in a nursing home or similar facility or is about to be admitted to one or is otherwise facing existing and identifiable creditors, the attorney's participation might be deemed improper. See ABA/BNA *Lawyers Manual on Professional Conduct,* 1001: 1801, (1995). Some commentators even contend that participating in any transfer, the purpose of which is to hinder, delay or defraud creditors, even though no claim has arisen, is unethical. Rosen & Rothschild, Asset Protection Planning, *Tax Management Portfolio*, no. 810 2d (2002).

Although beyond the scope of this column, an attorney who participates in such transactions may also become personally liable. In some jurisdictions, an aggrieved creditor may bring actions against the attorney based on theories of a civil conspiracy and aiding and abetting a fraudulent transfer.

Beil Estate, continued

but would have to sell "the house" to satisfy debt. The court deemed this exchange "a 'contract' in the loosest sense" but nonetheless found that the writing evidenced the decedent's "crystal clear" intention that the beneficiary designation not change. In further support of this conclusion, the court cited several cases in which other jurisdictions have concluded that emails may be used to satisfy the Statute of Frauds for the purpose of establishing a contract under the Uniform Commercial Code.

Practice Points

BY BERNICE J. KOPLIN
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Practice Points is a new feature in the Probate Section Newsletter. Readers are welcome to send items for consideration to include to Bernice J. Koplin at bjkoplin@sglk.com.

When filing the Pennsylvania Inheritance Tax return two copies are filed with the Register of Wills. One is retained locally by the Register while the other is transmitted to the PADR. What if your client does not wish for certain sensitive information (by way of example, the last several years of corporate tax returns included because of the ownership of a business interest) to be exposed to local curiosity? The PADR suggests that the return to be retained locally need not attach copies of such sensitive information to the return, but that such sensitive information be attached to the return only to be remitted to the PADR.

WHAT WOULD YOU LIKE TO SEE IN FUTURE ETHICS COLUMNS?

Send your questions and ideas to:

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Tax Update

By JOAN AGRAN
McCAUSLAND, KEEN & BUCKMAN

I. COURT DECISIONS

Informal Claim for Refund Meets Requirements

In *Estate of Wilshire*, 102 AFTR2d 2008-6946, 2008 WL 4858256 (DC Ohio, 11/10/08), decedent died in 2000 with a Will directing that charitable bequests not be charged with the payment of taxes. The executor submitted a copy of the Will with the estate tax return, indicating that an amended return would be necessary due to the charitable deduction calculation. Over the next two years, the executor had numerous communications with the Service regarding the proper estate tax calculation and requested the refund of any overpayments. In 2004, when the executor discovered that taxes had been improperly charged to the charitable bequests, the estate filed a Form 843 refund claim.

Although the Service accepted the substance of the refund claim and refunded $56,802, it refused to refund the balance of almost $430,000, because the two-year statute of limitations had expired. The estate filed suit, claiming that (i) there was no dispute as to the material fact, and (ii) the executor made an informal claim within the statute of limitations through his repeated oral and written communications to the Service, as well as through the submission of the Will with the original tax return, which made it clear that charitable bequests should not be charged taxes. The estate further argued that, while its appeal of the partial disallowance was pending, the Service purged its file relating to the estate's claim.

On the basis of these facts, the District Court held that the estate had met the requirements for an informal claim; the facts and circumstances demonstrated that the Service was on notice that the estate was asserting a right with respect to an overpayment of tax. Although the accountants hired by the estate improperly prepared the returns, the Service had the Will in its possession, was instructed by the estate of the proper interpretation of the Will and calculation of the taxes, received the estate's request for a refund, and conducted an extensive audit. The court further found that the Service should not benefit from purging its file after the estate gave notice of the refund claim.

Supreme Court Declines Review of Estate Tax Valuation Case

The Supreme Court has declined the Service's request to review the Eleventh Circuit decision in *Jelke Est. v. Comr.*, No. 05-15549 (CA 11, 11/15/07), cert. denied

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Tax Update, continued

(2008, S.Ct.) 2008 WL 2481919). As previously reported in this newsletter, when decedent died in 1999, his revocable trust owned a 6.44% stock interest in a closely held investment holding company. At the time of his death, the company owned, among other assets, appreciated marketable securities worth $178 million with a built-in contingent capital gains tax liability of $51 million.

Decedent's estate valued the stock on the estate tax return by reducing the company's net asset value by 100% of the built-in capital gains tax liability and then applying discounts for lack of control and lack of marketability. The Service issued a notice of deficiency, using a zero discount for the built-in capital gains tax liability and reducing the discounts for lack of control and marketability. At trial, the Tax Court rejected the estate's position that the stock must be reduced by 100% of the built-in capital gains tax liability, holding that a smaller discount was appropriate.

On appeal, the Eleventh Circuit vacated and remanded the Tax Court's decision, instructing the Tax Court to recalculate the date-of-death net asset value of the company and the value of decedent's interest in the company using a dollar-for-dollar reduction for the built-in capital gains tax liability under the assumption that the company is liquidated on the date of death and all assets are sold. In determining the discount for the company's capital gains tax liability, the court followed the Fifth Circuit's approach in *Dunn Est. v. Comr.*, 301 F.3d 339 (5th Cir. 2002), which allowed a 100% dollar-for-dollar reduction, calculating the estate tax after taking into account only those facts known on the date of death. There was a strong dissent in the Eleventh Circuit, which adopted the Tax Court view that the built-in capital gain tax liability should be discounted to its present value to reflect the period of time over which the liability is reasonably expected to be incurred.

Assets Transferred to FLPs Included in Decedent's Estate

In *Hurford Est. v. Comr.,* T.C. Memo 2008-278 (12/11/08), decedent's husband died in 1999 with a Will that created a family trust and a marital trust. In 2000 decedent set up three family limited partnerships which received cash, stock and real property with a total value of approximately $14 million from decedent, the marital trust, and the family trust. Decedent and her children then immediately entered into an agreement whereby decedent transferred a 96.25% interest in the partnerships to her children in exchange for a private annuity providing fixed annual income for the rest of her life. Decedent died in 2001, ten months after entering into the private annuity transaction.

Following the filing of the estate tax return, the Service issued a notice of deficiency of $9.8 million, plus penalties of $2 million. The Service's position was that the private annuity transaction was a sham, and that the assets transferred into the family limited partnerships should be included in decedent's estate under Code Sec. 2035.

On the basis of these facts, the Tax Court held that the transfers of assets to the partnerships were not bona fide and for full and adequate consideration and therefore the value of those assets should be included in decedent's estate. The court further stated that under Code Secs. 2036(a) and 2038, the transfer of decedent's partnership interests for the private annuity was not bona fide and for adequate and full consideration because the children paid the decedent back with the very assets she transferred to them in exchange for the annuities, and that the annuities' values weren't set at the transfer date fair market value. Decedent retained an impermissible interest in the assets through the private annuity and so the assets transferred to her children must be included in her estate. The Tax Court also held that the only purpose for creating the partnerships was to allow a tax discount, that the transfer of assets to the partnerships was not bona fide, and therefore the transfer did not effectively remove the assets from decedent's estate.

Deductions Disallowed For Religious School Tuition Payments

In *Sklar v. Comr.,* No. 06-72961 (9th Cir. 12/12/08), the Ninth Circuit denied for the second time taxpayers' deductions for a portion of tuition payments paid to religious schools. The Ninth Circuit, in *Sklar v. Comr.*, 282 F.3d 610 (9th Cir. 2002), had previously upheld the Tax Court's denial of the deduction taken on taxpayers' 1994 tax return of a portion of the cost of taxpayers' children's religious school tuition. Taxpayers had claimed the deduction after learning of a confidential closing agreement between the Service and the Church of Scientology that allowed deductions for certain religious educational services.

Following taxpayers' claimed deductions on their 1995 returns and the Service's and the Tax Court's disallowance, taxpayers again appealed to the Ninth Circuit. The Ninth Circuit denied the deductions, holding that the 1995 tuition payments were not deductible as charitable contributions because

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payments for religious education are not deductible and the tuition payments were not "dual payment" contributions. The court stated that to qualify as "dual payment" contributions, the payment must exceed the value of the benefit received and there must be an intention of making a gift. In this case, taxpayers failed to establish that the tuition payments exceeded the value of the education received and that there was an intention of making a gift.

The Ninth Circuit further held that the closing agreement with the Church of Scientology does not constitutionally or administratively require the Service to allow charitable deductions for taxpayers' tuition payments. The court restated its earlier holding, further stating that it considers the closing agreement with the Church of Scientology to be an unconstitutional denominational preference and that it will not extend that preference.

Estate Entitled to Deduct Settlement Proceeds Paid to Charity

In *Williams Est. v. Comr.,* T.C. Memo 2009-5 (1/6/09), decedent, who died in 1998 without heirs, left her closely held stock to the family of the man who had founded the company with her late father, and the residue of her estate to four charities. Litigation in state court ensued over whether the stock had been sold prior to decedent's death, whether the sale terms were fair, and whether the family had abused a position of trust with decedent as she grew older. A settlement agreement was reached, as a result of which the charities received a total of $24 million. The estate filed a refund claim, arguing that the charities received more than the charitable deductions originally reported. The Service disagreed.

On the basis of these facts, the Tax Court held that 90% of the $24 million paid to the charities pursuant to the settlement of estate litigation was deductible. The court found that the payments under the settlement agreement were 90% a replacement for damages to the value of the stock and that they should be treated like other estate assets distributed to charity.

Estate's Expert Accurately Calculated Valuation Discounts

In *Litchfield Est. v. Comr.,* T.C. Memo 2009-21 (1/29/09), decedent died in 2001 leaving an estate that included shares in two closely-held companies. Decedent's estate owned 43.1% of the first company with 18 family member shareholders and a total value of $33.2 million, consisting of $23.4 million in farmland and related equipment and $9.8 million in marketable securities. Decedent's estate owned 22.9% of the second company with about 50 extended family member shareholders and assets including marketable securities and other equity investments with a total value of $52.8 million.

The estate's valuation expert discounted the estate's interest in the first company by 17.4% for built-in capital gain taxes, by 14.8% for lack of control, and by 36% for lack of marketability. The estate's expert discounted the estate's interest in the second company by 23.56% for built-in gains, 11.9% for lack of control, and 29.7% for lack of marketability. The Service, based on its own expert's valuations of the relevant percentage discounts, determined a estate tax deficiency of $6.2 million.

On the basis of these facts, the Tax Court held that the estate's expert calculated the built-in capital gain tax discount and lack of control discount more accurately than the Service's expert. The court explained that because under Code Sec. 2031 the fair market value of property is a question of fact based on the hypothetical price between a willing buyer and willing seller, valuation of stock should reflect built-in capital gain tax, lack of control, and lack of marketability discounts where appropriate.

The court determined that the estate's expert's valuation of the built-in gain tax discount was based on more accurate data than the Service's expert's valuation, which was based in part on wrong assumptions as to management's plans. The court also concluded that the estate's expert's valuation of the lack of control discount was more accurate because it reflected the majority of the company's assets, which consisted of farmland rather than marketable securities. However, the court determined that the estate's expert's valuation of the lack of marketability discount was high, particularly when combined with the lack of control discount amounts that the court was allowing.

IRS Annuity Tables Apply in Valuing Estates' Lottery Interests for Estate Tax Purposes

In *Negron v. United States*, 103 AFTR 2d 2009-634 (6th Cir. Jan. 28, 2009), two individuals who had won portions of an Ohio lottery prize in 1991, both died in 2001 with 15 lottery payments remaining. The payments were not assignable and could not be used as collateral. The executor for each estate elected to receive a lump-sum cash settlement of $2,276,000 from the Ohio lottery commission, representing the present value of the remaining payments using a 9% discount rate from the state

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valuation tables in effect in 1991.

The Service issued notices of deficiency in both estates, valuing each estate's lottery interest using the applicable Code Sec. 7520 discount rate. After paying the additional estate taxes and interest, the estates filed refund suits. The district court granted part of the estates' summary judgment motion, concluding that an exception to the IRS tables was warranted in valuing the estates' restricted lottery interests because the tables created an unreasonable and unrealistic result and there was a more reasonable and realistic way to determine value. The Service appealed.

On the basis of these facts, the Sixth Circuit reversed, holding that the district court incorrectly reasoned that IRS annuity tables produced an unrealistic and unreasonable result. The Sixth Circuit joined the Fifth Circuit, the Tax Court, and two district courts, and opposed the Second and Ninth Circuits, holding that for estate tax purposes the actuarial tables under Code Sec. 7520 must be used to value a nonassignable annuity award won in a state lottery. The court stated that a marketability factor wasn't necessary to determine the value of a guaranteed income stream; the value of the decedent's interest at the time of death was readily ascertainable and fairly reflected by the present value of the remaining payments using the IRS annuity tables in effect on the date of death.

Estate Taxes do not Reduce Marital Deduction

In *McCoy Est. v. Comr.*, T.C. Memo 2009-61 (3/19/09), decedent, a Utah resident, died in 2002 with a Will that distributed the residue of his estate to his revocable trust. The trust specified that the trustee was to pay all estate taxes attributable to decedent's entire taxable estate and decedent's debts and expenses from the residue of the trust before any distributions. After all payments are made under the tax provision, the trustee was to make certain specific bequests and, if his wife survived, was to hold the residue of the trust for her benefit.

Decedent's estate tax return claimed a marital deduction of approximately $3.9 million, the value of all property included in decedent's estate that passed to his wife. The estate, using equitable apportionment, reduced the specific bequests to persons other than wife by decedent's estate taxes before distributing those bequests. The Service issued a deficiency notice, finding that equitable apportionment did not apply because the trust directed that the taxes be paid from the residue, thereby reducing the value of the property passing to wife by the estate taxes, and reducing the marital deduction by more than $800,000.

On the basis of these facts, the Tax Court held that the state's equitable apportionment statute applied to decedent's estate taxes. The court stated that state law governs the manner in which estate taxes are apportioned and in this case, Utah law provides for "equitable apportionment," whereby estate taxes are charged to only the property generating or creating the tax liability unless the decedent's Will or other instrument clearly expresses a contrary intent. Where as here it was unclear whether the trust's tax provision refers to only the trust residue, which is held in trust for wife, or to the residue as described in Decedent's will, which includes property passing to others, the ambiguity is to be resolved in favor of apportionment. As a result, the marital deduction was not reduced.

Estate's Partial Interest in Artwork Valued

In *Stone v. U.S.*, No. 07-17068 (9th Cir. 3/24/09), an estate appealed a district court's judgment which upheld the Service's appraisal of an art collection. As previously reported in *Stone v. US*, 99 AFTR 2d 2007-1 (ND CA May 25, 2007), decedent's estate tax return valued decedent's ½ interest in an art collection with a 44% fractional discount based on expert opinion. On audit, the Service increased the total value of the collection (due to its higher valuation on 2 of 19 paintings) and disallowed the discount, finding it inapplicable. A California district court upheld the Service's total appraisal, finding that the value of a partial interest in an art collection should include a discount for the costs of partitioning the collection, rather than a regular discount for lack of marketability. The court rejected the estate's appraiser's analogy to the marketability discount for real estate, stating that a hypothetical seller of an undivided interest in artwork would not sell the artwork at a discount.

On the basis of these facts, in an unpublished opinion, the Ninth Circuit affirmed the district court's adoption of the government's 5% discount rate rather than the larger rate claimed by the estate. The court found no clear error in the district court's conclusion that the evidence offered by the estate did not hold up, based on the appraiser's total lack of experience with the art market and the unreasonable valuation rates used in the appraisal.

FLP Assets Included in Decedent's Estate Under Code Sec. 2036

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In *Jorgensen Est. v. Comr.,* T.C. Memo 2009-66 (3/26/09), decedent and her husband established a family limited partnership, each contributing marketable securities to the partnership in exchange for limited partnership interests. Decedent's children and husband were listed as general partners, although the children did not make any contributions to the partnership. The children and grandchildren were also listed as limited partners. Following husband's death, decedent formed another family limited partnership, funded with cash and marketable securities. The children were listed as general and limited partners and the grandchildren were listed as limited partners, although again they did not contribute assets to the partnership. Decedent did not file gift tax returns for the initial gifts of partnership interests, although she did file gift tax returns for partnership interest gifts made in subsequent years.

Decedent used partnership funds as her own, including payment of her income taxes and other expenses. Following decedent's death in 2002, her estate used partnership funds to pay estate taxes and other expenses. The Service determined that the assets decedent had transferred to the partnerships were includible in her estate under Code Sec. 2036.

On the basis of these facts, the Tax Court held that the assets decedent transferred to the partnerships were included in her gross estate under Code Sec. 2036 because decedent retained the use, benefit, and enjoyment of the transferred assets until her death and the transfers were not bona fide sales. In concluding that decedent had an implied agreement to retain an interest in the transferred assets, the court noted, among other factors, that (i) decedent had not retained sufficient assets after the transfers to satisfy her desire to make gifts to family members, (ii) decedent and her estate used a significant amount of partnership assets to pay decedent's pre- and post-death obligations, and (iii) the parties violated the partnership requirements for pro rata distributions to partners.

II. IRS REVENUE RULINGS, REVENUE PROCEDURES AND NOTICES

Reprieve for Deduction of Bundled Fiduciary Fees

In Notice 2008-116, 2008-52 IRB, the Service has provided that, for tax years beginning before Jan. 1, 2009, nongrantor trusts and estates will not have to 'unbundle' a fiduciary fee into costs that are fully deductible and those that are subject to the 2% floor under Code Sec. 67(a). The full amount of the bundled fiduciary fee can be deducted without regard to the 2% floor. The Service had originally provided this relief only for tax years beginning before Jan. 1, 2008.

The Supreme Court, resolving a conflict in the circuit courts, held in *Knight v. Commr,* 101 AFTR 2d 2008-544 (S Ct 1/16/2008), that investment advisory fees paid by a trust are deductible only to the extent that they exceed 2% of the trust's adjusted gross income. Reasoning that Code Sec. 67(e)(1) excepts from the 2% floor only those costs that would be uncommon, unusual, or unlikely for an individual to incur, the Court found that the trustee failed to demonstrate that it was uncommon or unusual for individuals to hire an investment adviser.

Previously, in late July of 2007, the Service had issued proposed regs providing that investment advice costs incurred by an estate or non-grantor trust would be subject to the 2% floor under Code Sec. 67(a). Under Prop Reg § 1.67-4(c), an estate or non-grantor trust that pays a single fee that includes both costs that are unique to estates and trusts and costs that are not, would have to use a reasonable method to allocate the single fee between the two types of costs. These proposed regs which require the cost to be unique to an estate or trust to be excepted from the 2% floor are more restrictive than the Supreme Court's decision in *Knight*, which excepts those costs which would not commonly or customarily be incurred by individuals. The Service is planning to issue final regs consistent with the Supreme Court's holding in *Knight*. Because the final regs, which will only apply prospectively, were not issued before the due date for filing 2007 income tax returns (determined without regard to extensions), the Service provided interim guidance in Notice 2008-32, 2008-11 IRB 593, for tax years beginning before Jan. 1, 2008. Because the final regs will not be issued in time to be applicable to the 2008 tax year, the Service has now extended that guidance to tax years beginning before Jan. 1, 2009.

Service Modifies Actuarial Valuation Tables to Address Lower Interest Rates

In Notice 2009-18, 2009-10 IRB, the Service provides supplements to the Code Sec. 7520 actuarial tables for valuing annuities, terms certain, reversions, and remainders by providing factors for interest rates below 2.2%. Due to the fact that the Code Sec. 7520 interest rate recently fell below 2.2%, which was the lowest interest rate under the existing tables, and because none of the existing published tables provide factors for interest rates below 2.2%, the Notice furnishes extensions to

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the existing tables for such rates.

III. IRS PRIVATE LETTER RULINGS AND TECHNICAL ADVICE MEMORANDA

Puerto Rican Resident 'Nonresident Non-US Citizen' For Estate and Gift Tax Purposes.

In PLR 200848014, taxpayer's mother, who was born in Puerto Rico, and taxpayer's father, who was a citizen of a foreign country (where taxpayer was born) moved to the United States and then to Puerto Rico, where they resided. Taxpayer and his family became naturalized citizens of the United States. Except for a five-year period attending college in the United States, taxpayer continuously resided in Puerto Rico since his family moved there.

On the basis of these facts, the Service ruled that taxpayer is a 'nonresident not a citizen of the United States' for purposes of Code Sec. 2501(c) and will continue to be for such time as he remains a resident of Puerto Rico. Under Code Sec. 2501(c) a donor who is a citizen of the United States and a resident of a possession thereof shall, for purposes of the gift tax, be considered a 'nonresident not a citizen of the United States' if the donor acquired citizenship solely by reason of (i) being a citizen of such possession or (ii) birth or residence within such possession. In this case the Service found that taxpayer acquired U.S. citizenship by reason of his residence in Puerto Rico.
The Service further ruled that taxpayer will be a 'nonresident not a citizen of the United States' for purposes of Code Sec. 2209 at the time of his death provided that at such time he is a resident of Puerto Rico or another possession of the United States. Under Code Sec. 2209 a decedent who was a citizen of the United States and resident of a possession thereof at the time of death shall, for purposes of the estate tax, be considered a 'nonresident not a citizen of the United States' if the decedent acquired citizenship solely by reason of (i) being a citizen of such possession or (ii) birth or residence within such possession.

No Deduction for Trust's Accelerated Payments to Charities

In CCA 200848020, a testamentary trust provided that the trustee shall pay a certain percentage of the trust's property annually to decedent's six children and a certain percentage of the trust's property annually to specified charities. The trust contained no termination date and did not provide for any modification of the annual payments by the trustee. In order to ensure that the trust would meet the definition of a designated beneficiary trust under Code Sec. 401(a)(9), the trust was reformed by court order, which modified the interests of decedent's children and the specified charities. The reformed trust provided that the trust transfer a certain percentage of the value of the trust outright to the specified charities, with the balance of the trust assets to be held in separate shares for decedent's children.

On the basis of these facts, the Chief Counsel's Office advised that the trust was not entitled to an income tax deduction under Code Sec. 642(c)(1) for the payments made to the charities because the payments were not made pursuant to the governing instrument. Under Code Sec. 642(c)(1), a trust is allowed as a deduction an amount paid for a charitable purpose pursuant to the terms of the governing instrument. Rev. Rul. 59-15, 1959-1 C.B. 164, and case law provide that a settlement agreement arising from a will contest qualifies as a governing instrument; however, the Chief Counsel's Office found that those authorities do not hold that a modification to a governing instrument will be construed to be the governing instrument in situations where the modification does not stem from a conflict. The Chief Counsel's Office concluded in this case that the accelerated payments to the charities are not considered to be made pursuant to the governing instrument.

Code Sec. 6166 Election Not Timely Made

In CCA 200848004, decedent's parents, who were named as personal representatives in decedent's Will, retained an accountant to prepare decedent's federal estate tax return. The accountant, finding that the return would not be ready by the original due date, requested an extension of time to file, to which he attached a statement indicating that it was expected that the estate would be eligible to make a Code Sec. 6166 election. The return was filed 10 days after the extended due date. The Service denied the Code Sec. 6166 election, since it was not made with a timely filed estate tax return.

On the basis of these facts, the Chief Counsel's Office advised that Regs. §301.9100-3 allows for additional extensions, but these extensions are only available for regulatory elections, and the Code Sec. 6166 election is a statutory election, not a regulatory election. The Chief Counsel's Office further found that the statement attached to the request for extension was not a valid Code Sec. 6166 election because (i) pursuant to Code Sec. 6166(d) and Regs. §20.6166-1(b), a Code Sec. 6166 election must be attached to a timely filed estate tax return, not a request

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for extension of time to file an estate tax return, and (ii) the statement did not assert a Code Sec. 6166 election, but only stated that it was anticipated that the estate would be eligible for such an election.

Gifts to Foreign Charitable Trust Qualify for Gift and Estate Tax Deductions

In PLR 200901023, taxpayer, a U.S. citizen and resident, created a foreign trust to make her deceased husband's artwork available for public exhibition and to provide funding for visual art education and training. She made an initial endowment to the trust and plans to bequeath most of her husband's artwork and archives to the trust at her death. Although the trust provides that it must operate for exclusively charitable purposes, taxpayer does not plan to file for recognition of exempt status under Code Sec. 501(c)(3).

The trust will loan husband's artwork to public galleries and museums and the trust's archives will be available to academic researchers, artists, and others with reasonable cause to examine the archives. The trustees may sometimes sell items from the collection for funds to support future activities as an addition to the original endowment funding. The trustees will also give financial support and encouragement through grants (complying with Code Sec. 4945) or loans to other charities in accordance with the trust's charitable purposes.

On the basis of these facts, the Service ruled that taxpayer's gift to the trust will qualify for a gift tax charitable deduction under Code Sec. 2522(a) and her bequest to the trust will qualify for an estate tax charitable deduction under Code Sec. 2055(a) if (i) at taxpayer's death, she is a U.S. citizen or resident, (ii) the trust operates in a manner during her lifetime and the terms of the lifetime and testamentary transfers satisfy the requirements of Code Secs. 2055 and 2522, and (iii) at her death, the trust conforms with the facts and representations made in taxpayer's ruling request.

The Service explained that although Code Sec. 508(d) provides that no estate or gift tax charitable deduction is allowed for transfers to or for entities not qualified under Code Sec. 501(c)(3), trusts described in Code Sec. 4947(a)(1) are exempted from this rule. In concluding that the trust was a Code Sec. 4947(a)(1) trust, the Service noted that (i) the trust is a trust for federal tax purposes, (ii) the trust was not exempt under Code Sec. 501(a), (iii) all of the trust's assets will be devoted to charitable purposes, and (iv) gift and estate tax charitable deductions will be available for transfers to the trust. The Service therefore determined that, for purposes of Code Secs. 2055(e)(1) and 2522(c)(1), Code Secs. 508(d) and 4948(c)(4) will not bar estate and gift tax charitable deductions for taxpayer's transfers to the trust.

Non-Qualified Disclaimer of Interests Subject to Gift Tax but not GST Tax

In PLR 200901013, settlors, husband and wife, created an irrevocable GST Nonexempt trust for the benefit of their four children. If a child predeceases the settlors, the child's share of the trust passes to the child's issue. Each of the settlors' children proposes to disclaim his or her entire interest in the trust more than nine months after the date of the transfer creating the interests.

On the basis of these facts, the Service ruled that the children's disclaimers will be transfers subject to gift tax under Code Sec. 2501. The disclaimers will be non-qualified disclaimers under Code Sec. 2518 because they will not be made within nine months of the date of the transfer creating the interest. The disclaimed property will therefore be treated for federal gift, estate, and generation-skipping transfer tax purposes as passing from each child to his or her children who are entitled to receive the property as a result of the disclaimer.

The Service further ruled that with respect to the portions of the trust in which the children become transferors for generation skipping transfer tax purposes, neither the trust nor any grandchild of the settlors will be subject to generation skipping transfer tax upon any future distributions to a grandchild of the settlors. Each child will make a transfer subject to gift tax and will therefore be treated as the transferor for generation skipping transfer tax purposes to the extent of the gift.

Qualified Personal Residence Trust Still Qualifies After Modification of Trust Agreement

In PLR 200901019, mother deeded her interest in her personal residence to a qualified personal residence trust, retaining a term interest to occupy the residence. At the end of the term, the trust would continue for the benefit of her two sons, and following mother's death, the trust is to terminate and be distributed to her sons.

Following the termination of mother's interest, mother, in her capacity as trustee, with the joinder and consent of her sons, modified the trust to allow the trustee to provide a gift of a term interest in

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the property to anyone that the majority of the remainder beneficiaries so choose. The sons intend to create a new irrevocable trust, intended to meet the requirement of a qualified personal residence trust, to which they will transfer their interest in the residence. The new trust will provide mother with a term interest to possess and occupy the residence, following which the residence will pass outright to the sons.

On the basis of these facts, the Service ruled that Code Secs. 2702(a)(1) and (2) will not apply to the sons' proposed transfer of the residence to the new trust if (i) the new trust instrument is substantially similar to the sample in Rev. Proc. 2003-42, 2003-1 C.B. 993, §4, (ii) the trust operates in a manner consistent with the terms of the trust instrument, (iii) the trust is a valid trust under applicable local law, and (iv) the residence qualifies as a personal residence under Regs. §25.2702-5(c)(2).

Trust Qualifies for Charitable Income Tax Deduction

In PLR 200906008, the primary beneficiary of an irrevocable trust has a lifetime limited power of appointment to order the distribution of all or any portion of the trust assets to one or more charitable organizations. The beneficiary intends to exercise this power upon receipt of a favorable letter ruling from the Service that such distribution from the trust would qualify the trust for a charitable income tax deduction under Sec. 642(c).

On the basis of these facts the Service rules that because the trust is making a gift authorized by the terms of the governing instrument for a purpose described in Sec. 170(c), the Service will allow the deduction, provided that the other requirements of Sec. 642 are met.

Discretionary Income Beneficiary Holds General Power of Appointment over Whole Trust

In PLR 200907025, a trust agreement provided that decedent had (i) the right to income distributions at the discretion of the trustee with the consent of an unnamed individual, and (ii) the right to receive distributions of the trust estate at the termination of the trust, whether the trust terminated at the expiration of the period fixed for its existence or by voluntary dissolution. Decedent had no right to trust corpus during his lifetime, and at his death, his equitable interest in the trust, unless disposed of otherwise by the decedent, was to pass to his heirs at law.

The decedent's estate acknowledged that decedent had a pre-October 22, 1942 testamentary power of appointment over the trust, and that the decedent had in fact exercised the power on his death. However, the estate argued that because the decedent was entitled only to discretionary income distributions, and because the trust didn't terminate at the decedent's death, the decedent's power of appointment was not a general power of appointment. The estate's position was that from an examination of the entire trust document, the grantors did not intend to give the decedent a general power.

On the basis of these facts, the Service found that the decedent had a general power of appointment which was thought to be consistent with the overall intent of the document. The fact that the decedent could receive only income at the trustee's discretion, and could not receive distributions of corpus during his life, in no way indicated that the grantors intended to restrict the decedent's power to appoint the trust property at his death; the trust language granting the power of appointment did not limit the exercise of the power to his discretionary income interest. In addition, the fact that any appointee had to wait until the termination of the trust to receive a distribution was irrelevant in determining whether the power was a general power. The fact that the decedent could not possibly receive trust corpus on the termination of the trust, years after his death, did not bar the decedent's estate, his creditors, or the creditors of his estate from receiving the trust property. Therefore, the value of the entire trust was includible in the decedent's gross estate.

Calculation of Amount Required as Collateral Under Code Sec. 6324A

In CCA 200909044, the National Office addresses the calculation of the amount of the special lien under Code Sec. 6324A for estate taxes on closely held business interests, deferred under Code Sec. 6166. Code Sec. 6324A provides that the maximum value of property that may be required as collateral shall not exceed the total of the amount of the deferred taxes and the amount of interest expected to become payable during the first four years of deferral. Code Sec. 6601(i) provides that the interest on the deferred estate taxes on the first $1,330,000 in value of a closely held business is calculated at a two percent interest rate and that the interest on any remaining deferred taxes is paid at 45 percent of the regular underpayment rate. The Service stated it would use its judgment to use the flat two percent rate, even if that is less than 45% of the underpayment interest rate; provided that if 45% of the underpayment interest rate is less then 2% at the time of the calculation, the Service is required to use the lesser amount.

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