PHILADELPHIA BAR ASSOCIATION

Probate and Trust Law Section Newsletter

No. 118 Published by the Section on Probate and Trust Law of The Philadelphia Bar Association September 2007

Report of the Chair

By KATHLEEN A. STEPHENSON
PEPPER HAMILTON LLP

It is a Saturday afternoon in August and I am about to go on vacation. But, I first I have to write this column and get it to Bob Louis the editor of the Probate and Trust Law Section's Newsletter. Bob has been patiently waiting for me to do my duty and I would not even think of leaving town without doing it and not because he would be upset (although he would rightfully be so). I will not let Bob down because Bob and Publications Committee he chairs never let the Section down. They consistently produce a quality Newsletter and the Section is very much the better for it.

The Publications Committee is one of many Section committees. The Rules and Practice committee chaired by Nina Stryker reviews the Philadelphia County Orphans' Court Rules, makes suggestions for improvements or clarification and even consults with the court on drafting new rules where necessary.

The Legislative Committee chaired by Tom Hiscock was active in the development of the new Pennsylvania Uniform Trust Act and reviews and comments on behalf of the Section on pending legislation.

The Education Committee chaired by Karen Stockmal is responsible for the substantive portion of the Section's quarterly meetings. This committee is already planning the topics for 2008!

The Elder Law Committee chaired by Keelin Barry offers monthly topics for discussion and is the first to make them

continued on Page 2

Inside this Issue...

The Friction Over Fractions: Changes in Charitable Donation Rules............................2

Recent Cases...............................3

What Every Pennsylvania Lawyer Needs to Know about the New Jersey Real Estate Tax....................................4

Standing to Enforce a Charitable Trust............................7

The New Representation Law under Pennsylvania's Uniform Trust Act.......................8

Ethics Matrix 2007....................14

Ethics Column...........................23

Tax Update................................24

THE FRICTION OVER FRACTIONS: CHANGES IN CHARITABLE DONATION RULES

By MATTHEW S. WILCOX

The Pension Protection Act of 2006 (PL 109-280), signed by President Bush last August, included several sections addressing charitable donations and appraisal requirements. The museum world and wealthy donors alike have expressed concerns about the chilling effect of this new legislation. Section 1218 is drawing the brunt of criticism.

Section 1218 addresses Partial Interests in Tangible Donated Property. Fractional gifts of art to museums are a common practice that allows a donor to enjoy partial or even full possession of an art object over time as ownership gradually transfers to the recipient institution. Despite fractional or even full ownership, receiving institutions often do not expect to take possession of donated art until the death of the donor. Critics have charged that this practice allows the very wealthy to "donate their cake and eat it too," with no net benefit to the public at large.

The new law provides that a receiving institution must take full ownership of the donation with 10 years of the first fractional gift or the death of the donor, whichever comes first. The tax deduction would be lost and a penalty earned if this deadline is not met. Under the prior law, there was no specified time frame for completing the transfer.

Moreover, once any fractional interest has been donated, the receiving institution must take possession of the art object for some period of time each year. No longer can the donor retain full possession, even if the institution is willing.

Most important, however, is the change related to the amount of the deduction a donor can claim on a gift donated in fractions over time. Previously the deduction amounted to the pro-rated Fair Market Value of the gift at the time of each fractional donation. With the thriving art market as it is, this practice accounted for appreciation and generally made each subsequent fraction more valuable than the last. The new law requires that the donor use as a basis the lesser of the FMV at the time of the first fractional gift and the value at the time of any subsequent gifted fractions. In a bullish art market, this essentially freezes the value of

continued on Page 3

Report of the Chair, continued

available via pod casts. The Tax Committee chaired by Jill Fowler does the same in the tax arena.

In addition, the Section is served by Bill Levy, the Corporate Fiduciaries Liaison; by Kathryn H. Crary, the Young Lawyers Liaison; by Jay Foster, the Legislative Liaison; by Bernice Koplin, the Tax Section Liaison and by Ralph Teeters who represents the Section on the Board of Governors. And of course, the Section's Executive Committee is instrumental in setting our goals and priorities.

The Section's committees vary considerably in their focus and structure but each fills a vital role for the Section. As different as the committees may be, I know that each chair shares one wish: more members! Whatever your interest may be, there is a committee that will peak it. Committee membership offers a chance to share interests and experience or to develop an interest and to gain experience. I know that Bob will have a form in this Newsletter telling you how to sign up for a committee. If you prefer, call me at 215-981-4311 or e-mail me at stephensonk@pepperlaw.com and tell your interests.

So, why get involved? In my last letter, I noted that our status as attorneys places us in a privileged position. With that privilege comes the obligation to provide always needed pro bono services but also the chance to help shape the practice of probate and trust law by being active in the Section through committee membership. We need you! We need your ideas, your insights and your efforts.

But, if all of the above is not enough incentive, consider this: committee membership is one of the best ways to get to know a friend in this field. And who wouldn't welcome the opportunity to call a friend and ask "Have you ever thought of this?"

Recent Cases

In Re: Estate of Bruce Anthony Trowbridge, Deceased, 2007 Pa. Commw. LEXIS 173 (Jan. 10, 2007): In an opinion filed on January 10, 2007, the Commonwealth Court of Pennsylvania reminded executors and administrators of the difficulties involved in asserting the affirmative defenses of statute of limitations and laches against the Pennsylvania Department of Revenue (the "Department") when the Department seeks to collect inheritance tax.

The case involved a decedent who died in an automobile accident in December 1989. Decedent's brother served as the Administrator of his estate. On May 8, 1997, the Administrator filed a Pennsylvania Inheritance Tax Return showing no assets in the estate. Then, twelve days later, the Administrator settled a wrongful death and survival action that the Administrator had filed in 1991, which resulted in a $413,278 payment to the estate as part of the survival action. In February 1998, the Department issued a notice of inheritance tax appraisement, seeking inheritance tax in the amount of $71,148. Receiving no response, the Department filed a petition for citation against the Administrator with the trial court. On December 10, 1999, the Administrator filed an answer, specifically denying that any inheritance tax was due. For unexplained reasons, no hearing ever took place and the case remained dormant. In July 2005, the Department filed a motion for hearing with the trial court.

In February 2006, at the second of two hearings on the case, counsel for the Administrator argued that the Department's petition should be dismissed due to the statute of limitations and the doctrine of laches. Agreeing with the Administrator, the trial court dismissed the Department's citation "due to a violation of the Statute of Limitations." In a subsequent opinion, the trial court indicated that it was relying on the doctrine of laches in its dismissal, on the grounds that the Department had "unreasonably delayed [its] claim."

On appeal, the Commonwealth Court (the "Court") reversed. The Court pointed out that neither the Inheritance and Estate Tax Act, 72 P.S. §§ 9101-9196, nor the Judicial Code, 42 Pa. C.S. §§ 101-9909, sets forth any specific statute of limitation with regards to inheritance taxes. The Court noted, however, that the Pennsylvania Supreme Court has applied a "catch-all" statute of limitations in claims against an estate. *In Re: Estate of Dr. Ronald G. Livingston,* 531 Pa. 308, 612 A.2d 976 (1992). This "catch-all" limitation, found at section 5527(b) of the Judicial Code, provides a general six-year statute of limitations for any civil action which is not subject to another limitation. Applying this provision, the Court found that the Administrator did not receive any settlement proceeds until May 1997, and that the 5527(b) six-year statute of limitations was tolled when the Department issued its first notice of inheritance tax appraisement in February 1998.

As to the defense of laches, the Court, citing *Commw. v. Western Md. Railway Co.*, 377 Pa. 32, 105 A.2d 336 (1954), noted that Pennsylvania courts are generally reluctant to apply the doctrine against the Commonwealth and will require a stronger showing by a defendant who attempts to apply the doctrine against the Commonwealth. The Court further explained that the Administrator had not properly raised the defense of laches as new matter in his answer, but rather had mentioned the defense for the first time at the February 2006 hearing. In addition, the Court pointed out that the Administrator had not presented any evidence of prejudice as a result of the delay, nor had he presented any evidence in support of his claim that no taxes were due.

KATHRYN H. CRARY

Duty of a Trustee Confronted with an Order from a Family Court in Another Pa. County to Pay Trust Income to a 3rd Party

In Re: Third Account for Testamentary Trusts F.B.O. Herbert B. Chadwick, Orphans' Court Division, Court of Common Pleas of Montgomery County. H. Beatty Chadwick

continued on Page 4

Charitable Donation Rules, continued

a work of art at an out-of-date and lesser value.

Heretofore, with the art market surging and limitations on the amount of charitable donations one can claim in relation to adjusted gross income, gifting in fractions over a long period of time gave a donor a successful tax strategy, and the recipient museum a reliable increase to its permanent collection. Given the new legislation, museums are expecting donations to decrease. For this reason, the Association of Art Museum Directors, and other agencies, are lobbying for a re-write of this part of the law.

Matthew S. Wilcox is a member of the Appraisers Association on America and Vice President of Trusts & Estates at Freeman's Auction House.

What Every Pennsylvania Lawyer Needs to Know about the New Jersey Estate Tax

By GLENN A. HENKEL, JD, LLM, CPA

In 2002, the Commonwealth of Pennsylvania, like the State of New Jersey, "decoupled" the state estate tax from the federal state death tax credit amount allowed by §2011 of the Internal Revenue Code. This may be where the similarity between the two states ends. After the Economic Growth Tax Relief Recovery Act of 2001 (EGTRRA 2001), many states "decoupled" their state estate tax from the state death tax credit amount. As many estate planners know, before EGTRRA 2001, the federal government provided a dollar-for-dollar credit against the federal estate tax in an amount allowed by I.R.C. §2011. This tax collection represented "easy money" for states because the federal government administered the tax and the home "state" of a decedent merely received a specified dollar amount based upon the federal rate structure. In addition, in any state where a decedent held real property, the state treasury received a ratable portion of the tax.

EGTRRA 2001 made two significant changes for the states. First, the increase in the federal estate tax exemption (from then, $675,000 to now $2,000,000) limited the number of estates that would be subject to federal estate tax (thus, cutting state revenue). Further, over the years 2002 to 2004, the federal government "phased out" the benefit of the tax allowed by §2011. This loss in revenue (together with declining state revenue from income tax) caused many state legislatures to act — New Jersey and Pennsylvania among them.

One of the first differences between the Pennsylvania and New Jersey structure is that the Pennsylvania Constitution Article VIII, Section 1, contains a "uniformity" clause resulting in doubt over the constitutionality of the change, which was retroactively repealed (Act No. 46 of 2003, 12/23/2003). Many practitioners in Pennsylvania believed the Pennsylvania version of the tax to be unconstitutional, due to the graduated rate structure keyed to the estate tax exemption amounts in effect before EGTRRA was passed.

continued on Page 5

Recent Cases, continued

("Chadwick") has been embroiled in protracted spousal support litigation in Delaware County Family Court. Chadwick is also the beneficiary of a trust under the jurisdiction of the Montgomery County Orphans' Court. Upon Chadwick's failure to comply with his support obligations, the Family Court issued an Order directing previously-escrowed and future trust income distributions to Chadwick's ex-wife. The trustee complied with the Order, despite the fact that the trustee was not made a party to the action under Pa. R.C.P No. 1920.34 and Chadwick's ex-wife did not seek to execute the judgment in Montgomery County. Chadwick sought to surcharge the trustee for its "voluntary" compliance.

The Court ruled that the trustee should have filed a declaratory action with the Montgomery County Orphans' Court prior to distributing trust payments to Chadwick's ex-wife. However, the trustee's compliance with the Family Court Order and failure to file a declaratory judgment action did not warrant reprimand or surcharge in this instance because had the trustee filed the declaratory action, the Orphans' Court would have merely affirmed the Family Court's jurisdiction and directed the trustees to follow the Order.

In addition, the Court denied Chadwick's request to re-open and re-litigate previously adjudicated accounting periods, because the five-year statute of limitations had expired and Chadwick failed to demonstrate good cause, both of which are required under 20 Pa.C.S.A. § 3521.

Although the trustee in this case was not subject to a reprimand or surcharge because of these specific facts, the moral of this story is clear: a trustee faced with an order from a court in another Pennsylvania county to pay trust income to a third party should, to be safe, file an appropriate declaratory judgment action prior to compliance with the order.

DAVID A. RUBEN

New Jersey Estate Tax, continued

Second, Pennsylvania's version of the estate tax keyed the exemption to the increasing exemptions brought about by the 1997 Tax Relief Recovery Act; thus the Pennsylvania version would have risen to $1 million by 2006. New Jersey, on the other hand, treats all decedents dying after December 31, 2001 as if they had died on December 31, 2001. This has the effect of fixing the state estate tax "exemption" at a fixed-sum of $675,000. See N.J.S.A. 54:38-1(a)(2). As such, New Jersey resident decedents must be mindful that the state exemption remains intact notwithstanding the future of the federal estate tax exemption.

Both New Jersey and Pennsylvania enacted legislation in late June 2002 in connection with their fiscal year budgets. New Jersey, however, made this tax retroactive to decedents dying December 31, 2001. The New Jersey Courts have held the retroactive application of the estate tax to be constitutionally permitted; however, in one case, the New Jersey Supreme Court has recently granted certification *See, Oberhand v. Director, Div. of Taxation*, 388 N.J.Super. 239, 907 A.2d 428 (N.J.Super.A.D. Sep 29, 2006) Certification Granted by 190 N.J. 255, 919 A.2d 849 (N.J. Mar 20, 2007).

Unlike the Pennsylvania "uniformity clause", the New Jersey Constitution bears no similar language regarding the imposition of pro-rata taxes. An argument can be made that this law is unconstitutional under Article 4, Section 7, paragraph 5 of the New Jersey Constitution, which prohibits a law from being enacted by reference to a title of another act only. Also, any part of an act which relies on an existing law (or part) must restate the entire law relied upon at length in the New Jersey statutes. The theory seems to be designed to give citizens access to the entire provisions of the law relied upon without an "incorporation by reference" of the other law. While it has been held that statutory references in New Jersey law to I.R.C. §501(c)(3) organizations is constitutionally permitted, it remains unclear whether, or to what extent, this provision will have any merit if the New Jersey estate tax is challenged on a constitutional basis. *See, Princeton Tp. v. Bardin,* 147 N.J. Super. 557, 371 A.2d 776 (A.D. 1977), certification denied, 74 N.J. 281, 377 A.2d 685. The author is aware of no New Jersey challenge on this point.

Another difference between the Pennsylvania and New Jersey structure is in treatment of non-residents. The New Jersey estate tax (at this time) does not apply to non-residents. As a consequence, a multi-millionaire resident of Pennsylvania with a multi-million dollar beachfront house in New Jersey would not be obligated to pay any New Jersey estate tax, not even its ratable share as the value of the home relates to the total amount of estate death tax credit. See N.J.S.A. 54:38-1(a) (2) which begins, "Upon the transfer of the estate of every resident decedent..." (Emphasis added). By contrast, other states have imposed an estate tax on the ratable share of the state death tax credit amount under I.R.C. Section 2011. Pennsylvania residents with New Jersey property should be diligent to make sure that their Pennsylvania domicile is clear at the time of death.

Recently, several astute New Jersey taxpayers challenged the imposition of New Jersey tax on real property situated outside of New Jersey. (For a discussion of this issue See Evans, The Constitutionality of Decoupling, ABA Probate and Property, July/August 2005 at page 22). For example, if the tax on a $2,000,000 estate is $99,600 but the estate includes a condominium in Florida worth $500,000, shouldn't the tax be imposed on "only" the other $1,500,000? Alternatively, since one quarter of the estate was outside New Jersey, maybe only three quarters of the tax should be due (e.g., $74,700). Nevertheless, it is reported that the NJ Division of Taxation has recently capitulated in several cases involving not only out of state real property but also, trusts established by predeceased spouses that were not NJ residents (QTIP trusts originated in and located out of New Jersey).

Like Pennsylvania, New Jersey also imposes an inheritance tax on all transfers. New Jersey has enacted a "waiver" rule for the Estate tax similar to the waiver provisions under the New Jersey Inheritance tax. By way of background, in order to transfer property from an estate of a New Jersey decedent, the permission of the New Jersey Division of Taxation is needed. This is provided in a form called a "New Jersey Inheritance and estate tax waiver" issued by the Division. However, since 1988, inheritance tax transfers between decedents and "Class A beneficiaries" (spouse, children, grandchildren, etc.) are subject to tax at a zero (0%) percent rate, and thus are exempt. See N.J.S.A. 54:34-2. As such, for many transfers before 2002 subject to inheritance tax only, waivers could be obtained through a "self-executed" format. This was a simple affidavit of a beneficiary indicating that no New Jersey inheritance tax was due.

The waiver provisions were revised after the passing of the New Jersey estate tax to require an additional affirmation that the estate value is less than $675,000. As a consequence, the "self-executing"

continued on Page 6

New Jersey Estate Tax, continued

waivers no longer apply to many larger estates. Thus, in order to obtain clearance for distribution of estate assets, an estate tax return must be filed, tax paid and the "inheritance tax waiver" must be received from the Division of Taxation. For a large estate, a Pennsylvania taxpayer may need to obtain a New Jersey inheritance tax waiver on the basis of the exemption granted to non-residents. Many New Jersey title companies will forego the necessity of a waiver if they are convinced that the decedent was not a New Jersey resident.

The New Jersey Division of Taxation has adopted new forms for the Estate tax. These forms can be obtained in the New Jersey Division of Taxation website www.state.nj.us/treasury/taxation. The computation of the Estate tax can be based upon two alternate methods — the "simplified" method and the "706" method. Do not let the name of the "simplified" method fool you, it is no simpler than the "706" method (based upon an actual 2001 version of the federal IRS form 706). The genesis of this "simplified" provision was that taxpayers (including the New Jersey State Bar Association) objected as the legislation was being created. A concern was raised about the returns to be filed for taxpayers who did not meet the federal filing threshold (those estates between $675,000 and $1,000,000 in 2002 and 2003 and between $675,000 and $1,500,000 beginning January 1, 2004). The statute called for a "simplified" method to be adopted. See N.J.S.A. 54:34-1(c). In implementing this new method, the Division of Taxation merely based the Estate tax computation on the New Jersey inheritance tax. The New Jersey Inheritance tax form (Form NJ-ITR) must be completed and the figures on the form are used to complete the "simplified" method for the Estate tax. Of course, many estates would not be concerned about the filing of the New Jersey inheritance tax return because, while filing is required, no tax would be due if property passed to "Class A" beneficiaries (spouse and children). Nevertheless, estates in excess of the federal exemption amount must use the "706 method" which requires that the estate information merely be carried over to the state return.

The New Jersey estate tax is still relative new and therefore many questions remain unanswered. However, due to the significant differences between the New Jersey and Pennsylvania taxes, Pennsylvania practitioners should be cautious.

* * *

Glenn A. Henkel, Esquire is an attorney practicing with Kulzer & DiPadova, P.A., based in Haddonfield, New Jersey (with an office in Ocean City) and is a past Chair of the New Jersey State Bar Association Real Property, Probate and Trust Law Section and is author of New Jersey Estate Planning Manual: Theory, Practice and Forms (NJICLE.com, 2007) and contributing author on Mignogna, Estate and Trust Litigation (NJICLE.com, 2006).

JOIN A COMMITTEE

The Section's Committees depend on the steady flow of people, energy and ideas. Join one! Fill in the form below and send it to the Section Chair:

Kathleen A. Stephenson, Esquire
Pepper Hamilton LLP
3000 Two Logan Square
18th and Arch Streets
Philadelphia, PA 19103-2799
215-981-4311
email: stephensonk@pepperlaw.com

Name:	Committee Preferences:
Address:	First:
	Second:
Email:	Third:

Standing to Enforce a Charitable Trust

By GIL A. NUSBAUM
BALLARD SPAHR ANDREWS & INGERSOLL, LLP

Recently enacted Section 7735 of the Probate, Estates and Fiduciaries Code[1] has adopted the position of the Uniform Trust Code and changed existing Pennsylvania law by recognizing the settlor's right to initiate a proceeding to enforce a charitable trust. That Section provides that "[a] proceeding to enforce a charitable trust may be brought by the settlor during the settlor's lifetime or at any time by the Attorney General, a charitable organization expressly named in the trust instrument to receive distributions from the trust or any other person who has standing to do so."[2] However, without specific reference to Section 7735(c), the Pennsylvania Supreme Court has made clear that a special interest in the outcome of the litigation is still required in order for a private party to qualify as a person who has standing to enforce a charitable trust.

In *In re: Milton Hershey School and Hershey Trust Company*, 911 A.2d 1258 (Pa. 2006), decided shortly after Section 7735 took effect, the Pennsylvania Supreme Court held that the Milton Hershey School Alumni Association did not have a sufficient special interest to vest it with standing to seek enforcement of the Milton Hershey School Trust.[3] The case arose because the Alumni Association believed that the Trust's resources were being diverted from its purpose of helping orphaned children. The Alumni Association first sought the assistance of the Attorney General, who, after investigation into the matter, entered into an agreement in 2002 with the School and the Trust Company with respect to the administration of the Trust and the School. In 2003, however, the agreement was modified in a way that essentially rescinded the 2002 agreement. The Association subsequently initiated an orphans' court action seeking rescission of the 2003 agreement and reinstatement of the 2002 agreement.

The trial court granted the preliminary objections of the School and the Trust Company and held that that Alumni Association lacked standing to challenge the rescission of the 2002 agreement. The Commonwealth Court reversed, finding that the Alumni Association did have standing to seek enforcement of the Trust because it had a "special interest" in the matter. However, the Supreme Court reversed again and explained:

> The core concept of standing is that "a party who is not negatively affected by the matter he seeks to challenge is not aggrieved, and thus, has no right to obtain judicial resolution of his challenge." A litigant is aggrieved when he can show a substantial, direct, and immediate interest in the outcome of the litigation. A litigant possesses a substantial interest if there is a discernible adverse effect to an interest other than that of the general citizenry. It is direct if there is harm to that interest. It is immediate if it is not a remote consequence of a judgment.[4]

Furthermore, the Court noted that private parties generally lack standing to enforce charitable trusts.[5] The Attorney General, members of the charitable organization, and people having a special interest in the charitable trust are among those who have standing to bring an action for the enforcement of the trust.[6] However, a "person whose only interest is that interest held in common with other members of the public cannot compel the performance of a duty the organization owes to the public."[7]

The Court noted that the Milton Hershey School Trust does not mention the Alumni Association, and, in fact, it specifically excludes graduates of the School, who comprise the bulk of the Alumni Association's membership, from benefiting from the Trust. Although the Alumni Association was formed

continued on Page 8

[1] 20 Pa.C.S. § 7735.

[2] 20 Pa.C.S. § 7735(c).

[3] *In re: Milton Hershey School and Hershey Trust Company,* 911 A.2d at 1263.

[4] Id. at 1261-62 (internal citations omitted).

[5] Id. at 1262.

[6] Id.

[7] Id.

The New Representation Law Under Pennsylvania's Uniform Trust Act[1]

By KAREN A. FAHRNER, ESQ.
CHIEF OPERATING OFFICER AND CHIEF FIDUCIARY OFFICER
THE BRYN MAWR TRUST COMPANY

Last year, the enactment of Pennsylvania's Uniform Trust Act ("UTA") herded a variety of new statutes into the trust corral.[2] Some of these statutes related to representation,[3] compelling careful attention inasmuch as they have the potential to affect a wide range of trust activities.[4]

This article attempts to analyze certain aspects of the representation law in the nonjudicial resolution context under the UTA.[5] As a threshold matter, there are three express conditions required to make a nonjudicial resolution of a trust matter binding on parties not directly participating in the resolution: (1) the trustee must have notified the representative in writing, identifying the person, persons or class of persons to be represented by the representative; (2) the representative must not have declined the representation[6], and (3) the representative must have acted in good faith.[7] If these statutory conditions are met, the actions pertaining to the representative ("notice to, consent or approval of or the waiver or release") are binding on "a person, class of persons or both represented in accordance with section 7723."[8]

Aside from the good faith requirement noted above, the new representation law gives only a broad guideline to the representative, permitting him to consider the general benefit "accruing to the living members of the family of the person represented".[9]

Except in the case of representatives who are holders of certain presently exercisable or testamentary powers of appointment,[10] a representative's key qualification is to have "no conflict of interest with respect to the matter at issue between the representative and the person or persons represented" that might affect his "impartiality."[11] If he represents two or more persons, there must be no conflict of interest "between or among" the persons represented that might affect the representative's impartiality.[12]

How is a conflict of interest identified? A conflict of interest would be readily identified by comparing the parties' relative interests in the trust.[13] For example, a representative may have a current interest in the principal as a potential distributee under an invasion of principal clause as well as a future interest in the principal as a contingent remainderman, while the person represented may have only a future interest in the principal as a contingent remainderman. If the issue to be resolved were to pertain to the propriety of a current invasion of principal for

continued on Page 9

Standing, continued

at Milton Hershey's direction,[8] if the Hersheys had intended for the Alumni Association to have direct input on Trust affairs, they could have amended the Trust to reflect that intention.[9] However, they never did so.[10]

Thus, the Court concluded that "[t]o give the Association 'special interest' standing where the settlors of the Trust specifically denied beneficiary status to its members, would surely contravene the settlors' intent expressed through their written trust."[11] Although current law allowed the Alumni Association to urge the Attorney General to enforce the Trust, the Alumni Association's disagreement with the Attorney General's decision to modify the 2002 agreement was not sufficient to establish standing to challenge that decision in court.

Although Section 7735(c) of the Probate, Estates and Fiduciaries Code has expanded the law in Pennsylvania by recognizing the right of the settlor of a charitable trust to initiate a proceeding to enforce the trust, the Pennsylvania Supreme Court has made it clear that standing to the enforce a charitable trust does not extend to private parties unless they have a "special interest" in the outcome of the litigation. As the Milton Hershey School case illustrates, a relationship with the charitable trust will not be sufficient to establish a special interest. The private party asserting special interest standing must demonstrate a substantial, direct and immediate interest in the outcome of the litigation.

[8] Id. at 1259-60.

[9] Id. at 1263.

[10] Id.

[11] Id. at 1263.

The New Representation Law, continued

the benefit of the representative, the representative would have a "conflict of interest affecting his impartiality" in representing the other contingent remainderman.[14]

Who decides whether a conflict exists? It appears that the trustee decides, either directly or through trust counsel. While the new representation statutes do not expressly state that this responsibility lies with the trustee, it is a logical conclusion in light of the trustee's general duties under the UTA.[15]

While the new law requires the trustee to give notice to the representative, it does not require (or even discuss) the trustee's giving notice to the person to be represented. On the other hand, the new law does permit a sui juris person who is to be represented to object to the representation.[16] So, how is that person to know whether to object in the absence of receiving a notice of his own? In order to secure against a later challenge by that person, the trustee may want to give notice despite the lack of a statutory requirement to do so. Yet, it may also be reasonable for the trustee to conclude that the new law permits him, as a matter of business judgment, to decline to give such notice under the circumstances (e.g., based on an evaluation of possible remoteness of the interest involved).

Apart from the need to overcome concerns about notice, conflicts and good faith, the trustee must further study the statutes in order identify the appropriate representative.[17] Some initial questions arise: Can an adult member of a class represent other adult members of the class? What constitutes a "class"? When is the "entitled" representative of "class" identified? Does the identification of a "class" and application of a particular part of the statute turn on the wording of the governing instrument in identifying beneficiaries? What is a "future event"? When does the "future event" occur in the application of the statute? What is "an additional future event"? These are all terms used in the new representation statutes.[18] The illustration below may help.

Illustration

Family Tree Facts: Assume grandmother (G) is deceased, having survived her husband. G's only children are D and S, both adults and sui juris. D is unmarried and has no descendants. S is married and has two adult, sui juris children (GS and GD) and one child who is still a minor (GM). GS has one child (M), who is a minor.

Nonjudicial Settlement Event: Assume that the trustee would like to have an informal approval ("nonjudicial settlement agreement") of his interim accounting, and that there are no known issues.[19]

Trust Terms: Assume the trust income is payable to D for life. At her death, the principal is distributable to G's "then living descendants, per stirpes."

Designated Representative Analysis: D has a life estate in income and the other family members have a contingent interest in the remainder. D cannot be a representative of G's descendants because she has a conflict of interest. She has an interest in the income of the trust that might affect her impartiality concerning the principal. Similarly, the other family members cannot represent D because of their having a conflict of interest by virtue of their interest in the trust principal. Accordingly, only D can represent herself as to the income interest.

Who may represent the contingent remaindermen? S, GD, GS, GM and M are all members of the same class (G's descendants) who might take the trust after D's death. All, except GM and M, are sui juris. There is another group (the unborn and unascertained) who also belong to the class of contingent remaindermen. Does PEF Code Section 7723 (4) or Section 7723 (5) apply?

We will first examine PEF Code Section 7723 (4). The first sentence of Section 7723 (4) states that "[w]here . . . an interest in property will pass to a class of persons upon the occurrence of a future event, the living sui juris class members represent the class members who are minors, unborn, unknown or unascertained." This sentence indicates that S, GD and GS represent GM and M, and also represent any other potential members of the class who are unborn, unknown or unascertained.[20] The second sentence of Section 7723 (4), however, indicates the time for identifying those who are "entitled" to be representatives. In our facts as applied to this second sentence, the class of remaindermen would be fixed as if the future event had occurred "immediately before" the effective date of the nonjudicial resolution (presumably the date of the agreement approving the accounting). While the members of the class who are sui juris consist of S, GD and GS, only S is "entitled" as the class member who would take the property if D's death ("the future event") were to have occurred immediately before the date of the approval of the accounting.[21]

PEF Code Section 7723 (4) appears to pertain to representation between or among the class of persons who would take upon the occurrence of a single (or first) event. Under the above facts, the

continued on Page 10

The New Representation Law, continued

"class" consists of G's descendants. The "future event" is D's death. Of the "class members", only S is the person(s) in the class "entitled" to represent the class, identified at the time of the approval, as if D had then died.[22] Despite this conclusion, it may be the cautious instinct of trust counsel and trustee alike to designate nonetheless GS and GD, along with S, to serve as the representatives of minors and those having more remote interests. However, this does not appear to be mandated by the statute.

What about the application of PEF Code Section 7723 (5)? This subpart refers to the possibility of property passing to a person or class of persons upon the occurrence of a future event as well as upon an "additional future event". Under our facts, the key "future event" (or "first event") is D's death, clearly. But how do we analyze an "additional future event"?[23] If we assume that S's death before D is an additional future event, the provisions of Section 7723 (5) direct us to look at the person, class of persons, or both, who would take upon the occurrence of the "first event" to identify the representative, provided that their interests are "identical or substantially similar" to those taking upon the occurrence of the additional future event. Accordingly, even if this Section were to apply to our facts, the answer should still be the same. S would be the "entitled" representative since the property would pass to S upon the occurrence of the "first event" (D's death).[24] Accordingly, S would be in a position to represent his adult children as well the interests of unborn or minor individuals.[25]

It is noteworthy that the official Comment to PEF Code Section 7723 senses the tension between Sections 7723 (4) and (5), and provides an illustration dealing with two clearly different "classes" ("descendants" vs. "heirs"). The assumed facts in the Comment are: a trust for spouse, at whose death the trust is distributable outright to testator's children (or descendants of deceased children), and in default of descendants to the testator's heirs. The Comment states that Section 7723 (5) would authorize the sui juris children to represent the heirs. This suggests that the "additional future event" in Section 7723 (5) is not the one triggering the disposition (the "first future event"), but the one establishing the eligibility of a person or class to take the trust.

If the class taking at the time of the first future event were to consist of, for example, two sui juris persons, it appears that, under PEF Code Section 7723 (4), both persons would be "entitled" to be representatives. There is no provision for one adult member of a class to represent other adult members of the same class where both would "take the property" if the future event had occurred immediately before the effective date of the nonjudicial settlement agreement. Accordingly, if we were to change our facts by having S predecease G, then GS and GD would both be entitled to be representatives.

Suppose instead we were to change our facts by stating that: S and D are both living; S has the same living descendants described in the illustration; D also has two adult, sui juris children (GS2 and GD2) and a child who is a minor (GM2), and GS2 has a child (M2), who is a minor. Since D's family line now mirrors S's family line, there would be two lines of descent upon D's death when the remainder would pass to G's descendants, per stirpes. Under Section 7723 (4), the "living sui juris class members" represent the class members who are minors, unborn, unknown or unascertained. The "class members entitled to represent other class members or potential class members" are the persons who would take as if the future event (D's death) had occurred. Under the new facts, the class members so entitled would be S, GS2, GD2 (with all of them representing the other adult class members and other class members who are minors, unborn, unknown or unascertained).

In conclusion, it appears that the new law regarding representation requires both careful legal analysis for compliance and astute business judgment for implementation, depending on the facts. Until more is understood about the application of the new law, trustees may find it advisable to ask trust counsel to confirm that the nonjudicial settlement agreement is indeed "binding."

Footnotes

1 © Copyright Karen A. Fahrner, Esquire, COO and Chief Fiduciary Officer, The Bryn Mawr Trust Company, Bryn Mawr, Pennsylvania. Ms. Fahrner gratefully acknowledges the analytical contributions of Michele L. Ahwash, CTFA, VP, The Bryn Mawr Trust Company, in the preparation of the text. This article is not intended to render legal advice. In dealing with specific legal matters, counsel should research original sources of authority.

2 *See* PEF Code Sections 7701–7799.3 ("UTA"). The UTA is based on the Uniform Trust Code (2000, am. 2001), the first national codification of the law of trusts ("UTC").

3 *See* PEF Code Sections 7721-7726.

4 *See*, e.g., PEF Code Sections 7709 (Methods and waiver of notice);

continued on Page 11

7710.1 (Nonjudicial settlement agreements); 7780.3 (Duty to inform and report); and 7785 (Limitation of action against trustee).

[5] *See* PEF Code Section 7722 (b). The other area where representation is addressed under Pennsylvania's UTA is in connection with judicial proceedings under PEF Code Section 7722 (a). With respect to this latter area, Pennsylvania fiduciary law has long embraced the notion of representation, albeit by certain persons other than a fiduciary, an attorney-at-law or a guardian or trustee ad litem. *See* PEF Code Section 751 (6) (". . . The court may dispense with the appointment of a guardian or trustee ad litem for a person who is a minor or otherwise legally incapacitated, unborn, or unascertained if there is a living person sui juris having a similar interest or if such person is or would be issue of a living ancestor sui juris and has an interest in the estate whose interest is not adverse to his. . . ."). 20 Pa. C.S.A. §751 (6), Oct. 12, 1999, P.L. 422, No. 39, eff. 60 days; July 7, 2006, P.L. 625, No. 98, eff. 120 days ("Act No. 98 of 2006"). PEF Code Section 751 (6) is rooted in Pennsylvania's Fiduciaries' Act of 1949 (P.L. 512, §§ 704, 983, amended 1955-56 P.L. 1084, 20 PS §§ 320.704 and 320.983), which, in turn, is based on Section 9 of the Uniform Trustees Accounting Act (NCCUSL, 1936, am. 1937). One should note that Act No. 98 of 2006 adopting Pennsylvania's UTA also amended PEF Code Section 751(6) by deleting the word "trust." Accordingly, Section 751 (6) now applies only to estates. However, old Section 751 (6) and the cases citing it regarding trusts may still be informative.

[6] *See* PEF Code Section 7725, requiring the trustee to give written notice to a person representing another, who may decline "by a writing that is given to the trustee no later than 60 days after the receipt of the trustee's notice."

[7] *See* PEF Code Section 7722 (b).

[8] PEF Code Section 7723 sets forth a list of requirements concerning representatives and persons represented.

[9] *See* PEF Code Section 7722 (c). It is noted that the term "family" is not defined, and does not necessarily appear to be limited to "immediate" family.

[10] With respect to these certain powers of appointment, PEF Code Section 7723 (7) provides that "whether or not there is a conflict of interest," any such holder may represent all potential appointees and takers in default of the exercise of the power of appointment if the holder may appoint to (i) the holder's estate, holder's creditors or the creditors of the holder's estate; or (ii) anyone other than the holder's estate, the holder's creditors and the creditors of the holder's estate. [Emphasis added.] It appears that Section 7723 (7) refers to a "general power" in (i), and a "broad limited power" in (ii), and that the exception to the rule requiring the absence of a conflict of interest is limited only to these types of powers. This is sensible inasmuch as the common law in Pennsylvania has long leaned toward treating such powers as "an estate tantamount to a fee". *See Perkin's Trust Estate*, 314 Pa. 49, 51 (1934). *See also* PEF Code Section 7753 (b) (Trustee's duties; powers of withdrawal) indicting that the holder of a withdrawal power is treated like a settlor to the extent of the property subject to the power during the period the power may be exercised. By contrast, note that there is no similar exception to the rule recited in PEF Code Section 7723 (8) dealing with all other types of powers of appointment (e.g., "limited powers", such as a power to appoint to descendants). Note also that the UTC contains no such exception to the rule for testamentary powers of appointment. See UTC §302 (Representation by Holder of General Testamentary Power of Appointment).

[11] *See* PEF Code Section 7723. To the extent that the representative is a member of the family of the person being represented, there may arguably be a "permissible" conflict of interest in considering the general benefit to the family under PEF Code Section 7722 (c), noted above in the text.

[12] *Id.*

[13] It is not clear whether the scope of any conflict of interest is limited to interests in the trust or whether it extends also to other matters outside the trust, such as family estrangements. The impartiality test appears to be fact-sensitive, but may be intended to apply only within the purview of the trust. This would be consistent with PEF Code Section 751(b) requiring only that the representative's "interest in the estate" not be "adverse." However, the last sentence in the Comment to UTC §304 states that the "representative may have interests outside of the trust that are adverse to the interest of the person represented, such as a prior relationship with the trustee or other beneficiaries. *See* Restatement (First) of Property §185 cmt. d (1936)." [Emphasis added.]

[14] *See* Comment to UTC §303, stating that a typical conflict would be

continued on Page 12

The New Representation Law, continued

where a parent seeking to represent the beneficiary holds an adverse beneficial interest.

[15] *See* PEF Code Sections 7771 (Duty to Administer Trust); 7780.4 (Discretionary powers); and 7772 (Duty of loyalty). Note also that Section 7772 pertains to conflicts of interest between the trustee and others.

[16] Under PEF Code Section 7726, a person may not represent another person who is sui juris and files a written objection to the representation with the trustee. Unlike PEF Code Section 7725, there is no time limit for objecting, which creates perhaps unintended logistical problems if not clarified in the notice to the persons to be represented. The Comment to UTC §301 (Representation: Basic Effect) states that a consent is not binding if the person represented "raises an objection prior to the date the consent would otherwise become effective". [Emphasis added.] Under PEF Code Section 7726, the legal effect of an objection appears to be stated in the title to the Section, to wit: "Representation ineffective if person objects." In that event, one may anticipate that the subject of a nonjudicial resolution could instead become the subject of a judicial resolution, the success of which would be a matter of risk analysis by the trustee and trust counsel.

[17] PEF Code Section 7723 contains nine subparts, listing candidates to serve as representatives. In reviewing the permissible candidates for representation, the trustee should also keep in mind that the governing instrument may have its own provisions regarding representation. *See* PEF Code Section 7705 (a) (providing that the trust instrument prevails over any contrary provision in Pennsylvania's UTA except in the limited circumstances described in PEF Code Section 7705 (b), none of which deal with representation). In addition, PEF Code Section 7721 (a) mandates that the provisions of PEF Code Sections 7721 -7726 apply to the UTA unless "the context clearly specifies to the contrary." Suppose the governing instrument designates a representative to serve in lieu of any of the candidates listed in PEF Code Section 7723 (e.g., a donor-appointed guardian is not included in the list under Section 7723). One would expect this designation to be permitted. But query whether the donor-appointed representative would still have to pass the conflicts and good faith tests under PEF Code Section 7723 in order to make the action binding or avoid any challenge by the person represented. What would be the trustee's mandate in this context? By analogy, *see* PEF Code Section 7780.3 (k) (Duty to inform and report), requiring the trustee to notify the appointee under the governing instrument that the "Section 7780.3 Notice" is being given to the appointee as representative of the named current beneficiary, and also giving the appointee 60 days to decline. Even if the governing instrument were expressly to preempt the Pennsylvania's UTA subchapter regarding representation, query whether eliminating conflicts and good faith would be upheld as against public policy in any event. By analogy, *see* PEF Code Section 7788 (Exculpation of trustee). Note, however, that the General Comment to UTC Article 3 states that "settlors are free to specify their own methods for providing notice and obtaining substituted consent."

[18] *See* PEF Code Section 7723 (4) and (5).

[19] It is not clear the extent to which representation in the context of approving a single event, such as an accounting, may be similar to other contexts, such as "on going" administration matters like the receipt of periodic statements of transactions. *See* PEF Code Section 7721(b) defining a "trust matter" to include a nonjudicial settlement pertaining to any matter listed in PEF Code Section 7710.1(d).

[20] Note that PEF Code Section 7723 (9) states that "a person represents the person's minor and unborn descendants" to the extent there is no guardian. It is not clear the extent to which this provision would apply in the face of the first sentence of PEF Code Section 7723(4).

[21] In light of this statutory language, it may be helpful to identify the "effective date" in the notice to the representative or in the nonjudicial settlement agreement approving the accounting, or both.

[22] One may argue that this interpretation (resulting in S being the sole representative) is technically imprecise since PEF Code Section 7723 (4) refers only to the plural (e.g., it begins by referring to property passing to a class of "persons"). By contrast, PEF Code Section 7723 (5) refers to property passing to a "person, class of persons or both." It does not appear that this distinction is intended to make a difference when the property would pass to just one person upon the occurrence of the first event.

[23] One may question whether S's death before D is an "additional future event" in that the only future event that will occasion the passing of property to anyone is D's death (i.e., the property has to pass to a class "upon" the occurrence of

continued on Page 13

The New Representation Law, continued

an additional future event, and S's intervening death, while admittedly an "additional future event" is not the one triggering the passing of property). Another reading of the statute would regard the "additional future event" as one giving rise to a new presumptive interest due to the death of an individual higher in the chain of interests (e.g., the property or interest in property will pass to another person, class of person or both due to [instead of "upon"] the occurrence of an additional future event). The Comment to PEF Code Section 7723 appears to depend on this latter interpretation in its illustration.

[24] As noted in the Comment to UTC §304, whether a "substantial identity" (as opposed to an "exact identity") exists may depend on the nature of the interest: "[f]or example, a presumptive remainderman may be able to represent alternative remaindermen with respect to approval of a trustee's report but not with respect to interpretation of the remainder provision or termination of the trust."

[25] *See* Comment to UTC §302, indicating that the representation principles will sometimes apply to adult and competent beneficiaries.

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:

Robert H. Louis, Esquire
Saul Ewing LLP
3800 Centre Square West
Philadelphia, PA 19102
215-972-7155
email: rlouis@saul.com

ETHICS MATRIX 2007

The latest codes of conduct for wealth managers and estate planners of all stripes.

Organization/Code	Confidentiality	Conflicts of Interest/Disclosure	Competence	Compliance	Compensation	Miscellaneous
AMERICAN ACADEMY OF ACTUARIES Code of Professional Conduct Effective Jan. 1, 2001 202-223-8196 www.actuary..org/pdf/prof/code of conduct pdf	An actuary shall not disclose to another party any confidential information unless authorized to do so by the principal or required to do so bylaw. —Precept 9	An actuary shall not knowingly perform actuarial services involving an actual or potential conflict of interest unless: (a) the actuary's ability to act fairly is impaired; (b) there has been disclosure of the conflict to all present and known prospective principals whose interests would be affected by the conflict; and (c) all such principals have expressly agreed to the performance of the actuarial services by the actuary. —Precept 7	An actuary shall perform actuarial services only when the actuary is qualified to do so on the basis of basic and continuing education and experience and only when the actuary satisfies applicable qualification standards. —Precept 2 An actuary shall ensure that actuarial services performed by or under the direction of the actuary satisfy applicable standards of practice. —Precept 3	An actuary must be familiar with, and keep current with, not only the code, but also applicable law and rules of professional conduct for the jurisdictions in which the actuary renders actuarial services. An actuary is responsible for securing translations of such laws or rules of conduct as may be necessary. —Code introduction	An actuary shall make appropriate and timely disclosure to a present or prospective principal of the sources of all direct and indirect material compensation that the actuary or the actuary's firm has received, or may receive, from another party in relation to an assignment for which the actuary has[provided, or will provide, actuarial services for the principal. The disclosure of sources of material compensation that the actuary's firm has received, or may receive, is limited to those sources known to, or reasonably ascertainable by, the actuary. —Precept 6	An actuary shall not engage in any advertising . . . with respect to actuarial services that the actuary knows or should know are false or misleading. —Precept 11
AMERICAN BANKERS ASSOCIATION Institute of Certified Bankers Professional Code of Ethics 1-800-226-5377 www.aba.com/NR/rdonlyres/67C0B822-5A9C-11D5-AB86-00508895258D/44636/ExamApplicationl.pdf	Safeguard the confidential nature of information concerning the business transactions and condition of my employer and of my employer's present and prospective customers, clients, borrowers or suppliers, except where disclosure of such confidential information is required by state or federal law regulation. —Part 7	Conduct my professional affairs in a manner that avoids a conflict of interest or the appearance of a conflict of interest. If I become a party to a conflict, or the appearance of a conflict is created, I shall inform my supervisor as soon as possible. —Part 1	Strive to become and remain proficient in carrying out my professional duties. If I accept responsibility for handling new and unusual professional activities, but I find that it is beyond my competency, then I agree that I am expected to become competent by diligently undertaking the work and study necessary to qualify myself, or to obtain the assistance of a professional possessing the necessary skills or competency. —Part 9	Not have signed, nor will I sign, a consent decree with the Securities and Exchange Commission (SEC) or any state securities agency or be found guilty nor will I be found guilty in a competent court of jurisdiction or a federal or state regulatory proceeding of any of the following offenses:.. . —See the rest of Part 8 for a list of offenses	Not specifically addressed in this code. Refer to code for relevant standards of conduct.	Owe a solemn duty to uphold the integrity and honor of my profession and to encourage respect for it. I further agree to promote the continual development of the financial services industry, as well as my respective organization. —Part 4

continued on Page 15

Organization/Code	Confidentiality	Conflicts of Interest/Disclosure	Competence	Compliance	Compensation	Miscellaneous
AMERICAN BAR ASSOCIATION Model Rules of Professional Conduct 202-662-1000 www.abanet.org' cpr/mrpc/mode/ rules. htm/	(a) A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).	A lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if: (1) the representation of one client will be directly adverse to another client; or (2) there is a significant risk	A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation. —Rule 1.1	A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity,	The scope of the representation and the basis or rate of the fee and expenses for which the client will be responsible shall be communicated to the client, preferably in writing, before or within a reasonable time after commencing the representation, except when the lawyer will charge a regularly represented client on the	A lawyer shall not accept compensation for representing a client from one other than the client unless: (1) the client gives informed consent; (2) there is no interference with the lawyer's independence of professional
AMERICAN BAR ASSOCIATION (Continued from previous page)	(b) A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes is necessary ... (Subject to certain exceptions, which vary from state to state, such as to prevent the client from committing a criminal act.) —Rule 1.6	that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer. —Rule 1.7		scope, meaning or application of the law. —Rule 1.2(d)shall	same basis or rate. Any changes in the basis or rate of the fee or expenses also be communicated to the client. —Rule 1.5(b)	judgement or with the client-lawyer relationship; and (3) information relating to representation of a client is protected as required by Rule 1.6. —Rule 1.8(f)
AMERICAN SOCIETY OF APPRAISERS Principles of Appraisal Practice *and Code of Ethics* Revised January 1994 703-478-2228 *www.appraisers.org/ join/code ethics.cfm*	The fact that an appraiser has been employed to make an appraisal is a confidential matter. (Contents of appraisal report also confidential.) —Section 4.1	The society declares that ... it is unethical and unprofessional for [an appraiser to accept an assignment to appraise a property in which he/she has an interest or a contemplated future interest. (Subject to certain exceptions after full disclosure.) —Section 7.3	It is not proper for an appraiser to accept an engagement to make an appraisal of a property of a type he is not qualified to appraise . . . —Section 4.2 (See also Section 3.4.)	Not specifically addressed in this code. Refer to code for relevant standards of conduct.	. . .the society declares that the contracting for or acceptance of any such contingent fee is unethical and unprofessional. (Similar restriction of commissions, finder's and referral fees.) —Section 7.1 *(See a/so Section 7.2* regarding percentage fees.)	Advocacy, as here described, affects adversely the establishment and maintenance of trust and confidence . . . and the society declares that it is unethical and unprofessional. —Section 7.5

continued on Page 16

Organization/Code	Confidentiality	Conflicts of Interest/Disclosure	Competence	Compliance	Compensation	Miscellaneous
THE APPRAISAL FOUNDATION *Uniform Standards of Professional Appraisal Practice (USPAP)* Ethics Provision As of July 1, 2006 202-347-7722 *www.appraisal foundation.org/htm// USPI AP2003/toc.htm*	An appraiser must protect the confidential nature of the appraiser; client relationship. —Ethics Rule Confidentiality Section	An appraiser must perform assignments ethically and competently, in accordance with USPAP and any supplemental [standards agreed to by the appraiser in accepting the assignment. An appraiser must not engage in criminal conduct. An appraiser must perform assignments with impartiality, objectivity, and independence, and without accommodation of personal interests. —Ethics Rule: Conduct Section	Prior to accepting an assignment or entering into an agreement to perform any assignment, an appraiser must properly identify the problem to be addressed and have the knowledge and experience to complete the assignment competently; or alternatively, must: (1) disclose the lack of [knowledge and/or experience to the client [before accepting the assignment; (2) take all steps necessary or appropriate to complete the assignment competently; and (3) describe the lack of knowledge and/or experience and the steps taken to complete the assignment competently in the report. —Competency Rule	These standards are for appraisers and users of appraisal services. To maintain a high level of professional practice, appraisers observe these standards. However, these standards do not in themselves establish which individuals or assignments must comply; neither The Appraisal Foundation nor its Appraisal Standards Board is a government entity with the power to make, judge, or enforce law. Individuals comply with these standards either by choice or by requirement placed upon them or upon the service they provide, by law, regulalion, or agreement with intended users. —Preamble [	The payment of undisclosed fees, commissions, or things of value in connection with the procurement of an assignment is unethical. (Subject to certain [disclosure exceptions.) —Ethics Rule: Management Section	An appraiser must prepare a workfile for each appraisal, appraisal review, or appraisal consulting assignment. The workfile must include the name of the client and the identity, by name or type, of any other intended users; true copies of any written reports, documented on any type of media; summaries of any oral reports or testimony, or a transcript of testimony, including the appraiser's signed and dated certification; and all other data, information, and documentation necessary to support the appraiser's opinions and conclusions and to show compliance with this rule and all other applicable standards, or references to the location(s) of such other documentation. —Ethics Rule: Record Keeping Section

continued on Page 17

Organization/Code	Confidentiality	Conflicts of Interest/Disclosure	Competence	Compliance	Compensation	Miscellaneous
ASSOCIATION FOR INVESTMENT MANAGEMENT AND RESEARCH changed to **CHARTERED FINANCIAL ANALYSIS (CFA) INSTITUTE** *Code of Ethics and Standards of Professional Conduct* Effective January 2006 434-951-5311 *www.cfainstitute.org/centre/ethics/code/*pdf/english code.pdf	Members and candidates must keep information about current, former, and prospective clients confidential unless: (1) the information concerns illegal activities on the part of the client or prospective client; (2) disclosure is required by law; or i (3) the client or prospective client permits disclosure of the information. —Standard V-E	Members and candidates must make full and fair disclosure of all matters that could reasonably be expected to impair their independence and objectivity or interfere with respective duties to clients, prospective clients, and their employer. Member and candidates must insure that such disclosures are prominent, are delivered in plain language, and communicate the relevant information effectively. *—Standard V-A* Members and candidates must use reasonable judgement in identifying which factors are important ... include those factors in communication with clients and prospective clients. Members and candidates must disclose to their employer, clients, and prospective clients, as appropriate, any compensation, consideration, or benefit received by, or paid to, other for the recommendation of products or services. *—Standard V-C*	Members and candidates must: (1) Exercise diligence, independence, and thoroughness in conducting investment analysis, making investment recommendations, and taking investment actions. (2) Have a reasonable and adequate basis, supported by appropriate research and investigation, for any investment analysis, recommendation, or action. -Standard V-A	Members and candidates must understand and comply with all applicable laws, rules, and regulations of any government, regulatory organization, licensing agency, or professional association governing their professional activities. Standard I-A members and candidates must not engage in any conduct that compromises the reputation or integrity of CFA Institute or the CFA designation or the integrity, validity, security of the CFA —Standard V-A	Members and candidates must not accept gifts, benefits, compensation, o r consideration that competes with...their employer's interest [unless they obtain written consent from all parties involved. —Standard IV-8	Members and candidates who possess material nonpublic information that could affect the value of an investment must not act or cause others to act on the information. —Standard II-A

continued on Page 18

Organization/Code	Confidentiality	Conflicts of Interest/Disclosure	Competence	Compliance	Compensation	Miscellaneous
ASSOCIATION OF FUNDRAISING PROFESSIONALS *Code of Ethical Principles and Standards of Professional Practice* Amended October 2004 703-519-8440 www..afpnet.org/ *content documents/* CodeofEthics/pdf	Members shall not disclose privileged or confidential information to unauthorized parties. —Standard 12	Members shall effectively disclose all potential and actual conflicts of interest; such disclosure does not preclude or imply ethical impropriety. —Standard 3	Members recognize their individual boundaries of competence and are forthcoming and truthful about their professional experience and qualifications. —Standard 6	Members shall comply with all applicable local, state, provincial, federal, civil and criminal laws. —Standard 5 Members shall not engage in activities that conflict with their fiduciary, ethical and legal obligations to their organizations and their clients. —Standard 2	Members shall not accept compensation that is based on a percentage of contributions; nor shall they accept finder's fees. —Standard 16	Members shall take care to ensure that all solicitation materials are accurate and correctly reflect their organization's mission and use of solicited funds. —Standard 7
CERTIFIED FINANCIAL PLANNER (CFP) BOARD OF STANDARDS, INC. Code of Ethics and *Professional Responsibility* Note: possible release of revisions in 2007 303-839-0680 *www.cfp.net/cert* ificants/conduct asp	A CFP board designee shall not reveal or use for his or her own benefit without the client's consent, any personally identifiable information relating to the client relationship or the affairs of the client. —Rule 501 (Exceptions are listed in parts a-d.)	A CFP board designee shall perform professional services in a manner that is fair and reasonable to clients, principals, partners, and employers and shall disclose conflict(s) of interest(s) in providing such services. —Principle 4	A CFP board designee shall offer advice only in those areas in which the CFP board designee has competence. In areas where the CFP board designee is not professionally competent, the CFP board designee shall seek the counsel of qualified individuals and/or refer clients to such parties. —Rule 302 See also Rule 301	In all professional activities, a CFP board designee shall perform services in accordance with: (a) Applicable laws, rules, and regulations of governmental agencies and other applicable authorities. (b) Applicable rules, regulations, and other established policies of the CFP board. —Rule 606	Upon request by a client or prospective client, the CFP board designee in a financial planning engagement shall communicate in reasonable detail the requested compensation information related to the financial planning engagement, including compensation derived from implementation. This disclosure may express compensation as an approximate dollar amount or percentage or as a range of dollar amounts or percentages. —Rule 403	A CFP board designee shall exercise reasonable and prudent professional judgement in providing professional judgement in providing professional services. —Rule 201
FINANCIAL PLANNING ASSOCIATION (FPA) Code of Ethics 1-800-322-4237 *www.fpanet.org/ member/membership/* join/ethics.cfm	An FPA member shall not disclose any confidential client information without the specific consent of the client unless in response to proper legal process, to defend against charges of wrongdoing by the FPA member or in connection with a civil dispute between the FPA member and client. —Principle 5	An FPA member shall perform professional services in a manner that is fair and reasonable to clients, principals, partners, and employers and shall disclose conflict(s) of interest(s) in providing such services. —Principle 4	An FPA member shall provide services to clients competently and maintain the necessary knowledge and skill to continue to do so in those areas in which the designee is engaged. —Principle 3	An FPA member's conduct in all matters shall reflect credit upon profession. —Principle 6	Not specifically l. addressed in this code. Refer to code for relevant standards of conduct.	An FPA member shall act diligently in providing professional services. Diligence is the provision of services in a reasonably prompt and thorough manner. Diligence also includes proper planning for and supervision of the rendering of professional services. —Principle 7

continued on Page 19

Organization/Code	Confidentiality	Conflicts of Interest/Disclosure	Competence	Compliance	Compensation	Miscellaneous
INSTITUTE OF BUSINESS APPRAISERS Code of Ethics Revised Feb. 28, 2004 954-584-1144 *www.goiba.org/* ethics.asp	Client data shall not, except under order of the following, be disclosed without a client's specific consent: (a) court order; (b) order of the ethics and discipline committee; (c) order of a licensing authority; or (d) order of another professional society's equivalent to the ethics and discipline committee, in which the member also holds a membership. —Rule 4	A member should always strive to be independent in the performance of professional services. Independence shall be considered impaired under circumstances which include the following: (a) The member has a direct or indirect financial interest in the business or entity being appraised. (b) The member is a director, officer or trustee of the entity being valued. (c) The member is a debtor or creditor of the entity on which a business appraisal is being performed. (d) There is a conflict of interest. —Rule 1	A member must competently complete the engagement, using due professional care. This includes planning and supervising employees and subcontractors. A member shall be responsible for the function and accuracy of all analysis tools used in an engagement including, but not limited to, computer software, financial calculators and purchased or subcontracted economic or industry reports. —Rule 3	A member shall not commit an act discreditable to the profession. —Rule 7	Services shall not be rendered where the fee is contingent upon the findings or results of such services, unless fixed by the courts or a governmental body or agency. —Rule 5	Advertising and solicitation shall not be false, misleading, harassing or coercive. —Rule 6
INTERNATIONAL ASSOCIATION FOR FINANCIAL PLANNING; (IAFP) merged with **FINANCIAL PLANNING ASSOCIATION (FPA)** *Code of Professional* Ethics	A member shall not disclose to another person any confidential information entrusted to or obtained by the member ... (Subject to certain exceptions.) —Rule 3.7	A member has the duty to disclose fully and accurately the material facts representing the true costs, benefits, and limitations of any service or product recommended; and disclose any actual or potential conflict of interest that could impair objectivity. — Rule 3.6i	A member shall keep informed on all matters that are essential to the maintenance of the member's professional competence in the area in which he/she specializes and/or claims expertise. — Rule 2.1	A member . . . has the duty to know and abide by the laws and regulations and all legal limitations pertaining to the member's professional activities. —Rule 3.1	A member shall not misrepresent the ... costs . . . of any financial planning service or product, whether the product or service is offered by the member or by another individual or firm. —Rule 5.2 See also Rule 3.2	A member shall support efforts to provide lay persons with objective information concerning their financial planning needs, as well as the resources, which are available to meet their needs. — Rule 5.1
MILLION DOLLAR ROUND TABLE *Code of Ethics* *See also* expanded *Code of Ethics* 847-692-6378 *www.mdrt.org/* ethics.html	Members shall: Hold in the strictest confidence and consider as privileged, all business and personal information pertaining to their clients' affairs. —Part 3	*i.* Always place the best interests of their clients above their own direct or indirect interests. —Part 1	Maintain the highest standards of professional competence and give i the best possible advice to clients by seeking to maintain and improve professional knowledge, skills and competence. —Part 2	Abide by and conform to all provisions of the laws and regulations in i the jurisdictions in which they do business. —Part 7	Make full and adequate disclosure of all facts necessary to enable their clients to make informed decisions. —Part 4	i Determine that any replacement of an insurance or financial product must be beneficial for the client. —Part 6

continued on Page 20

Organization/Code	Confidentiality	Conflicts of Interest/Disclosure	Competence	Compliance	Compensation	Miscellaneous
NATIONAL ASSOCIATION OF LIFE UNDERWRITERS changed to **NATIONAL ASSOCIATION OF INSURANCE & FINANCIAL ADVISORS (NAIFA)** *Code of Ethics* 877-866-2432 *www.naifa.org/about_ethics.htm/*	To maintain my clients' confidences. —Section 3	To present accurately and honestly all facts essential to my clients' decisions. —Section 6	To perfect my skills and increase my knowledge through continuing education. —Section 7	To keep informed with respect to applicable laws and regulations and to observe them in the practice of my profession. —Section 9	Not specifically addressed in this code. Refer to code for relevant standards of conduct.	To cooperate with others whose services are constructively related to meeting the needs of my clients. —Section 10
NATIONAL COMMITTEE ON PLANNED GIVING AND THE COMMITTEE ON GIFT ANNUITIES Mode/ Standards of Practice Revised April 1999 317-269-6274 www.ncpg/org/ethics standards/mode/sstandards.pdf	Not specifically addressed in this code. Refer to code for relevant standards of conduct.	It is essential to the gift planning process that the roll and relationships of all parties involved, including how and by whom each is compensated, be fully disclosed to the donor. —Section III	The gift planner should strive to achieve and maintain a high degree of competence in his or her chosen area, and shall advise donors only in areas in which he or she is professionally qualified. —Section V	A gift planner shall fully comply with and shall encourage other parties in the gift planning process to fully comply with both the letter and spirit of all applicable federal € and state laws and regulations. *—Section IX*	Compensation paid to gift planners shall be f reasonable and proportionate to the services provided. Payments of finder's fees, commissions or other fees by a done organization to an independent gift planner as a condition for the delivery of a gift are never appropriate. —Section IV	A gift planner acting on behalf of a charity shall in all cases strongly encourage the donor to discuss the proposed gift € with competent independent legal and tax advisers of the donor's choice. —Section VI
SOCIETY OF FINANCIAL SERVICE PROFESSIONALS Formerly AMERICAN SOCIETY OF CHARTERED LIFE UNDERWRITERS (CLU) and CHARTERED FINANCIAL CONSULTANTS (ChFC) Code of Professional Responsibility 610-526-2500 www.financialpro.org/About/CodeOfProfResp.cfm	A member shall respect and safeguard the confidentiality of sensitive client information obtained in the course of professional activities. A member shall not divulge such information without specific consent of the client, unless disclosure of such information is required by law or necessary in order to discharge legitimate professional duties. —Rule R3.1	A member shall perform services in a manner that represents the interests of all those he/she serves, including clients, principals, partners, employees, and employers. A member shall disclose conflicts of interests in providing such services. —Canon 1	A member shall maintain and advance his/her knowledge in all areas of financial service in which he/she is engaged and shall participate in continuing education programs throughout his/her career. —Rule R2.1 A member shall refrain from giving advice in areas beyond the member's own expertise. —Rule R2.2	A member has the duty [to know and abide by the local, state, and national laws and regulations and all legal limitations pertaining to the member's professional activities. —Rule R6.1 [	A member shall not engage in behavior involving concealment or misrepresentation of material facts. —Rule RI. I	A member shall act with patience, timeliness, and consistency in the fulfillment of his/her professional duties. —Canon 5

continued on Page 21

Organization/Code	Confidentiality	Conflicts of Interest/Disclosure	Competence	Compliance	Compensation	Miscellaneous
NATIONAL FOOTBALL LEAGUE PLAYERS ASSOCIATION (NFLPA) Regulations and Code of Conduct Governing Registered Player Financial Advisors www.nflpa.org/pdfs/FinancialAdvisors/NFLPA_code.pdf	Not specifically addressed.	A registered player financial advisor is prohibited from engaging in any activity which creates an actual or potential conflict of interest with the effective representation of a player . . . —Section IV-II-A-12 A registered player financial advisor is prohibited from providing false or misleading information to any player, or concealing material facts from any player, in the course of recruiting the player as a client, or in the course of representing or consulting with that player. —Section IV-11-A-7	A registered player financial advisor is prohibited from making false or misleading statement about his or her ability, degree, or area of competence —Section IV-II-A-8	A registered player financial advisor must fully comply with all federal and state laws governing the registered player financial advisor's professional activities *—Section 111-C* A registered player financial advisor is prohibited from engaging in any unlawful conduct and/or conduct involving dishonesty, fraud, deceit, misrepresentation, or any other activity which reflects adversely on his/her honesty, [trustworthiness, professional competence, and fitness as a registered financial advisor, or which otherwise jeopardized his/her effective representation of players —Section IV-II-A-9	A registered player financial advisor must execute and abide by a written contract which describes the services and financial advice to be provided to the player/client and the fees charged for those services and advice. *—Section Ill-H* A registered player financial advisor is i prohibited from providing [or offering money or any other thing of value, or extending credit or loaning money, to any player, or member of a player's family, or anyone in a position to influence the player, where such payment or loan was not disclosed to the player, I advance and in writing, or where such payment [or loan would violate any applicable law, regulations, rule or ethical standard —Section IV-II-A-11	
NATIONAL ASSOCIATION OF PERSONAL FINANCIAL: ADVISORS (NAPFA) Code of Ethics 1-800-366-2732 www.napfa.org/about/CodeofEthics.asp?	NAPFA members shall keep all client data private unless authorization is received from the client to share it. NAPFA members shall treat all documents with care and take care when disposing of them. Relations with clients shall be kept private.	Dealings and recommendation with clients will always be in the client's best interests. NAPFA members put their clients first.	NAPFA members shall strive to maintain a high level of knowledge and ability. Members shall attain continuing education at least at the minimum level required by NAPFA. Members shall not provide advice in areas where they are not capable.	NAPFA members will strive to maintain conformity with legal regulations.	NAPFA members shall fully describe method of compensation and potential conflicts of interest to clients and also specify the total cost of investments.	NAPFA members strive to be as unbiased as possible in providing advice to clients and NAPFA members practice on a fee-only basis.

continued on Page 22

Organization/Code	Confidentiality	Conflicts of Interest/Disclosure	Competence	Compliance	Compensation	Miscellaneous
THE DISCIPLINARY BOARD OF THE PENNSYLVANIA SUPREME COURT The Pennsylvania Code The Rules of Professional Conduct Adopted May 20, 1970 Promulgated by the Pennsylvania Supreme Court on April 1, 1998 www.pacode.com/secure/data/204/chapter8l/chap8ltoc.html	(a) A lawyer shall not reveal information relating to representation of a client unless the client consents after consultation, except for disclosures that are impliedly authorized in order to carry out the representation, and except as stated [in paragraphs (b) and (c). (b) A lawyer shall reveal such information if necessary to comply with the duties stated in Rule 3.3. (c) A lawyer may reveal such information to the extent that the lawyer reasonably believes the necessary. — Rule 1.6	(a) A lawyer shall not represent a client if the representation of that client will be directly adverse to another client, unless: (1) the lawyer reasonably believes the representation will not adversely affect the relationship with the other client; and (2) each client consents after consultation. —Rule 1.7	A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation necessary for the representation. . To maintain the requisite knowledge and skill, a lawyer should engage in continuing study and education. If a system of peer review has been established, the lawyer should consider making use of it in appropriate circumstances. —Rule 1.1	A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation necessary for the representation. —Rule 1.1	A lawyer shall not enter into an agreement for, charge, or collect an illegal or clearly excessive fee. Also, there is a list of factors in determining the propriety of a fee. —Rule 1.5	A lawyer shall act with reasonable diligence and promptness in representing a client. —Rule 1.3

ETHICS COLUMN

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

Question: May an attorney release a copy of a deceased client's estate planning documents, prior to the appointment of a personal representative, in an effort to prevent a Will contest?

Maintaining a client's confidences is among the most sacred duties an attorney has. That duty is set forth in Rule 1.6 of the Pennsylvania Rules of Professional Conduct. The duty continues after the client-lawyer relationship has terminated, and even after the death of the client. In fact, it has long been held that, even in the face of a subpoena, such confidences may not be revealed, and the lawyer presented with a subpoena is obligated to contest it by seeking a judicial protective order.

Once the client dies, the executor or administrator, known as a personal representative, is the only one who succeeds to a decedent's right to waive a privilege or consent to divulge confidential information. Until recently, careful practitioners would refrain from showing copies of estate planning documents to family members preparing for a Will contest, typically after a caveat has been filed to delay the probate of a Will. No personal representative had been appointed, so no one is empowered to authorize the disclosure. Scriveners can become quite frustrated by Rule 1.6. It would seem to bar the release of information that the decedent, if alive, would surely want released. The contents of the scrivener's file may be the key to resolving potential Will contests. In fact, the documents can serve as effective argument settlers. The best examples are prior Wills that show a consistent pattern of gifts – or omissions – long before the decedent is alleged to have executed a Will while lacking testamentary capacity or being subjected to undue influence.

A recent opinion of the Philadelphia Bar Association's Professional Guidance Committee, Opinion 2007-6, will be welcomed by trust and estate practitioners. It holds that scriveners have a right to rely in such instances on the exception found in Rule 1.6(a) which permits the disclosures of confidential information when "…impliedly authorized in order to carry out the representation…" The primary support for this conclusion is a quotation taken from the Commentaries to the Rules of Professional Conduct promulgated by The American College of Trust and Estate Counsel. The Commentary provides as follows:

Obligation After Death of Client. In general, the lawyer's duty of confidentiality continues after the death of a client. Accordingly, a lawyer ordinarily should not disclose confidential information following a client's death. However, if consent is given by the client's personal representative, or if the decedent had expressly or impliedly authorized disclosure, the lawyer who represented the deceased client may provide an interested party, including a potential litigant, with information regarding a deceased client's dispositive instruments and intent, including prior instruments and communications relevant thereto. A lawyer may be impliedly authorized to make appropriate disclosure of client confidential information that would promote the client's estate plan, forestall litigation, preserve assets, and further family understanding of the decedent's intention. Disclosure should ordinarily be limited to information that the lawyer would be required to reveal as a witness.

One point should be emphasized, however. Rarely should the entire file of a deceased estate planning client be released. The disclosure should be limited to information that the scrivener would be required to reveal as a witness and, for certain, only that information clearly needed to "carry out the representation."

WHAT WOULD YOU LIKE TO SEE IN FUTURE ETHICS COLUMNS?

Send your questions and ideas to:

Paul C. Heintz, Esquire
Obermayer, Rebmann,
Maxwell & Hippel LLP
1617 JFK Boulevard
One Penn Center
19th Floor
Philadelphia, PA 19103
215-665-3212
Email: paul.heintz@obermayer.com

TAX UPDATE

By JOAN AGRAN
MCCAUSLAND, KEEN & BUCKMAN

I. TREASURY REGULATIONS

Proposed Regs. Consider Post-Death Events to Determine Deductible Amount of Claims

In *REG-143316-03, 72 Fed. Reg. 20080 (4/23/07)*, the Service has issued proposed regs. clarifying the post death events that may be considered when determining amounts deductible under Code Sec. 2053. Deductions are limited to amounts actually paid in satisfaction of deductible expenses and claims. The regs. would apply to estates of decedents dying on or after the date they are finalized.

The proposed regs. seek to resolve the inconsistency in the way the courts have addressed the extent to which post-death events are to be considered in valuing claims. Among the points addressed:

1. Final court decisions as to the amount and enforceability of the claim or expense will be accepted if the court passes on the facts upon which deductibility depends.

2. Settlements will be accepted if reached in bona fide negotiations between adverse parties with valid claims recognizable under and not inconsistent with applicable law.

3. A protective claim for refund can be filed before the expiration of the period of limitations for refund claims in order to preserve the estate's right to claim a refund if the amount of a liability would not be ascertainable by the time of the expiration of the period of limitations.

4. A deduction will not be allowed to the extent the expense or claim is compensated for by insurance or is otherwise reimbursed.

5. No deduction can be taken on an estate tax return for a claim that is potential, unmatured, or contested at the time the return is filed.

6. When a claim against an estate lists multiple defendants, the estate can only deduct the decedent's portion of the liability. Claims by family members or beneficiaries of a decedent's estate would be more strictly scrutinized.

7. No deduction would be allowed for a claim that becomes unenforceable after the decedent's death.

8. For a claim requiring recurring payments to continue for a period extending beyond the final determination of the estate tax liability, a deduction will be allowed only as each payment is made, provided the period of limitations for claims for refund has not expired or the estate has properly preserved the claim for refund; alternatively, a deduction will be allowed for the cost of a commercial annuity purchased by the estate from an unrelated dealer in commercial annuities in satisfaction of such an obligation.

Proposed Regs. Address Retained Interests in Trust

In *REG.-119097-05, 72 Fed. Reg. 31487 (6/7/07)*, the Service has issued proposed regs. that would amend Regs. §20.2036-1 to incorporate the guidance provided in *Rev. Rul. 76-273, 1976-2 C.B. 268*, and *Rev. Rul. 82-105, 1982-1 C.B. 133, c*larifying that the amount includible in the decedent's gross estate from any grantor retained interest trust would be that portion of the trust corpus, valued as of the decedent's death, necessary to yield the annual payment using the appropriate Code Sec. 7520 interest rate in effect on the decedent's date of death. The proposed regs. apply to different types of trusts in which the grantor retains an interest, including GRITs, QPRTs, GRATs, CRATs and CRUTs. The proposed regs. provide both rules and examples for calculating the amount of trust corpus that would be included in a deceased grantor's gross estate under Code Sec.2036 in each case.

Because in many cases both Code Secs. 2036 and 2039 may be applicable to these retained interests, proposed Reg. §20.2039-1 clarifies that Code Sec. 2036, rather than Code Sec. 2039, would be applied in the future to these interests.

Proposed Regulations Issued on Code Sec. 67(e)(1) as Applied to Estates and Nongrantor Trusts

In *REG.-128224-06, 72 Fed. Reg. 41243 (7/27/07)*, the Service has issued proposed regs. under Code Sec. 67 to provide guidance on which costs incurred by estates and nongrantor trusts are subject to the 2% floor on miscellaneous itemized deductions. The regs. would apply to payments made after the date they are finalized. Code Sec. 67(e)(1) have been interpreted differently by various Federal Courts of Appeal in determining whether costs incurred

continued on Page 25

Tax Update, continued

by trustees (specifically, investment advisory fees) are subject to the 2% floor. The Preamble identifies the conflict among the circuits and observes that the split has led to differences in treatment for similarly situated taxpayers, depending upon their jurisdiction. Based on the Service's belief that similarly situated taxpayers should be treated consistently by having Code Sec. 67(e)(1) construed and applied in the same way in all jurisdictions, the proposed regulations are intended to provide a uniform standard for identifying the types of costs that are not subject to the 2% floor.

The proposed regs. would provide that only costs incurred by estates and nongrantor trusts that are unique to the estate or trust are not subject to the 2% floor. A cost would be considered unique under the proposed regulations if an individual could not have incurred that cost in connection with property not held in an estate or trust. The proposed regs. would determine which costs are subject to the 2% floor based on the type of services provided rather than on the taxpayer's characterizations of the services; a taxpayer cannot circumvent the 2% floor by bundling investment advisory fees and trustee fees together. The regulations would specify that an estate or nongrantor trust that pays a single fee including both unique and non-unique costs would have to use a reasonable method to allocate the fee between the two types of costs.

The proposed regs. would provide nonexclusive lists of the services that are exempt or non-exempt from the 2% floor. Products and services that are unique to an estate or trust would include those rendered in connection with (i) fiduciary accountings, (ii) judicial or quasi-judicial filings required as part of the administration of the estate or trust, (iii) fiduciary income tax and estate tax returns, (iv) the division or distribution of income or corpus to or among beneficiaries, (v) trust or will contest or construction, (vi) fiduciary bond premiums, and (vii) communications with beneficiaries regarding estate or trust matters. Products and services that are not unique to an estate or trust would include those rendered in connection with (i) custody or management of property, (ii) advice on investing for total return, (iii) gift tax returns, (iv) the defense of claims by creditors of the decedent or grantor, and (v) the purchase, sale, maintenance, repair, insurance or management of non-trade or business property.

The Service has asked for comments on whether any safe harbors or other guidance concerning allocation methods or otherwise would be helpful.

Final and Proposed GST Regs. Address Trust Severances

In *T.D. 9348, 08/01/2007*, the Service has issued final regs. on the qualified severance of a trust for GST tax purposes under Code Sec. 2642(a)(3) and proposed regs. on the GST tax consequences of trust severances that aren't qualified severances. The proposed regs. also would provide (i) guidance on the GST tax consequences of a qualified severance of a trust with an inclusion ratio between zero and one into more than two resulting trusts, and (ii) special funding rules for the non pro rata division of certain assets between or among resulting trusts.

In August 2004, the Service published proposed regs. providing rules for qualified severances under Code Sec. 2642(a)(3) which have now been adopted with various modifications. At the same time, the Service has issued new proposed regs. in order to further consider certain comments to the original proposed regs.

Subject to the proposed changes, Reg. §26.2654-1(b) will continue to provide rules for mandatory and discretionary severances of trusts includible in the transferor's gross estate, effective retroactively to the transferor's date of death. The final regs. under Reg. §26.2642-6 generally provide rules for the qualified severance of a trust if the severance will be effective only prospectively from the date of severance.

The final regs. apply for severances occurring after August 1, 2007. For a qualified severance occurring after December 31, 2000, and before August 2, 2007, taxpayers may rely on any reasonable interpretation of Code Sec. 2642(a)(3) as long as reasonable notice concerning the qualified severance and identification of the trusts involved has been given to the Service. For this purpose, the proposed regs. are treated as a reasonable interpretation of the statute. With one exception, the proposed changes would apply on or after the date the regs. are finalized.

II. COURT DECISIONS

Decedent Taxed as Sole Owner of Joint Account

In *Freedman v. Comm'r, TC Memo. 2007-61 (March 19, 2007)*, in September of 1999, decedent sold her interest in a business, receiving from the acquiring entity 525,000 shares of stock worth less than 30 cents per share. In January of 2000, decedent placed the stock in a joint brokerage account opened in the names of decedent and her son. When the value

continued on Page 26

Tax Update, continued

of the stock increased dramatically later in 2000, decedent sold 257,500 shares netting $2,974,392; she used $30,000 to purchase an R.V., $9,000 for her daughter and her husband, and deposited the remaining cash in her own bank account, leaving the remaining 267,500 shares in the brokerage account.

Decedent's income tax return for 2000 reflected the sale of the 257,500 shares, a basis of zero, and resultant long-term capital gain of $2,974,393. Decedent did not file a gift tax return for any years from 1999 through 2003. Son filed an income return for 2000 that reported no capital gain or loss.

Decedent died in June of 2003 while her 2000 income tax return was being audited. An amended return was subsequently submitted, reflecting gain from only one-half of the proceeds from the stock sales and a decrease in total tax, for which the estate requested a refund. The Service disallowed the refund.

On the basis of these facts, the Tax Court held that decedent owned all the shares at the time of the sales, and that she alone was taxable on the gain. In reaching its decision, the court relied on the fact that: (i) within days of each sale of the stock, decedent wired the proceeds out of the joint account into her own personal account, (ii) decedent's original 2000 income tax return reported the sale of all 257,500 shares of stock, (iii) she did not file a gift tax return for 2000, and (iv) son did not report any sale of shares on his 2000 income tax return. The Tax Court concluded that the estate failed to present clear and convincing evidence of an intent to make a gift to son when decedent established and funded the disputed joint account, as required by state law.

Certiorari Granted to Review Second Circuit Decision on Trust's Above-the-Line Income Tax Deduction

In *Rudkin Testamentary Trust v. Comm'r, 467 F3d 149 (2nd Cir. 2006)*, *rehearing en banc denied (Jan. 19, 2007), aff'g, 124 TC 304 (2005)*, *cert granted cert. granted sub nom. Knight v. Comm'r, ___ U.S. ___, 2007 WL 892736, 75 USLW 3530 (June 25, 2007)*, the Supreme Court agreed to review the Second Circuit opinion holding that a trust's income tax deduction for investment advice is subject to the 2% floor of the trust's adjusted gross income, under Code Sec. 67(e)(1). Oral arguments are scheduled for December. The Second Circuit's opinion was in accord with the holdings of the Tax Court, the Fourth Circuit, and the Federal Circuit and contrary to the holding of the Sixth Circuit. The rationale of the court differed from that of the other courts in that it requires that expenses deductible by a trust free of the 2% floor must be of a nature that nontrust taxpayers are "incapable of incurring," rather than those "incurred because of the trustee's duties" or those "not commonly incurred by individuals."

The Service Cannot Require a Mandatory Bond or Lien for Every Code Sec. 6166 Election

In *Roski Est. v. Comr., 128 T.C. No. 10 (4/12/07)*, decedent died in 2000 and in 2002, decedent's estate filed a federal estate tax return, reporting a balance due of nearly $33 million, together with a Notice of Election under Code Sec. 6166. In June 2003, the estate filed a supplemental return reporting a $29 million liability and an amended Code Sec. 6166 election to reflect the new balance due.

The Service notified the estate that, because of the Code Sec. 6166 election, the estate was required to either post a bond, or in lieu of a bond, elect to provide a special lien under Code Sec. 6324A. In a September 2004 letter, the estate requested that the government exercise its 'congressionally mandated discretion' and not require either a lien or a bond, giving as reasons that (i) the estate had been unable to find a bonding company willing to underwrite the amount in question; (ii) a lien would adversely affect the ability to carry on the family-owned business, and (iii) the risk was minimal.

In December 2004, the Service issued a notice of determination, denying the election under Code Sec. 6166, because the estate failed to fulfill the requirements for the election. The estate filed a petition for declaratory judgment in Tax Court seeking a redetermination of the Service's denial and a judgment that it was entitled to the election. The Service also moved for summary judgment, arguing that Code Sec. 7479 does not give the court jurisdiction to review the election because of the estate's failure to fulfill the prerequisite of a bond or a lien.

On the basis of these facts, the Tax Court held that: (i) it had jurisdiction under Code Sec. 7479 to review the Service's denial of the Code Sec. 6166 election, (ii) the Service had no authority to impose a bright line test, requiring a bond or a special lien in every case, and (iii) the Service's adoption of a standard that precludes the exercise of discretion is grounds to set aside the Service's determination. The court found that the legislative history of Code Sec. 6166 reveals that the bond requirement is

continued on Page 27

discretionary and was not intended to be mandatory where estates such as this one have liquidity problems that would make it difficult not only to pay tax but also to secure a bond or to secure their assets with liens. Because this was only a request for summary judgment, the court did not examine the specific facts or make a decision as to whether the estate would ultimately be subject to a bond or lien.

Donee Liable for Gift Taxes

In *U.S. v. Davenport, No. 06-40466 (5th Cir. 4/9/07)*, in 1980 decedent transferred stock of a company to two nephews and a niece; two of the transfers were via installment sales agreements that valued the stock at $804 per share and one was via an outright gift. In 1981, the company redeemed one nephew's shares at $2,190 per share. Following decedent's death in 1991, the nephews and niece were appointed as her personal representatives. After learning that a gift tax return had not been filed for the 1980 gift nor gift taxes paid, the estate filed the 1980 gift tax return and paid the gift taxes on the outright gift (using the $804 per share value) when the estate filed its estate tax return.

In a 1992 audit, the Service determined a stock value of $2,730 per share as to the 1980 gifts (including the partial gifts resulting from the installment sales). The estate contested the resulting gift tax liability and in 1997, the Tax Court determined that the value was $2,000 per share. The Tax Court also held that the statute of limitations did not bar the Service from recovering the gift taxes due because the statute started running when the estate filed the 1980 gift tax return in 1991. In 1999, the Tenth Circuit affirmed the Tax Court's decision. However, the estate did not pay the taxes owed and the Service then filed suit against the estate and decedent's nephews and niece in a district court in Oklahoma, seeking to collect the taxes based on Code Sec. 6324(b).

Following the transfer of the nephews' cases to two different district courts, and after appeal of one of the cases to the Fifth Circuit, the Fifth Circuit held one nephew liable for all gift taxes owed by decedent's estate for 1980 up to the value of the gift he received. Because the court determined that all elements of res judicata were satisfied, the court held that res judicata bound the nephew to the value of the company stock established in the Tax Court proceeding and precluded him from relitigating other issues that were or could have been litigated in that suit, such as whether the statute of limitations barred assessment of the gift tax on either the outright gift or the gifts arising from the installment sales.

The court explained that although the donor bears primary responsibility for paying gift taxes, (i) the donor's personal representative must pay the tax out of the estate, as a debt against the estate, if the donor dies before paying the gift tax owed, and (ii) under Code Sec. 6324(b), the donee may also be held personally liable for the entire unpaid gift tax, up to the value of the gift he or she received from the donor.

Family Limited Partnership Assets Included in Decedent's Estate Under Code Sec. 2036

In *Estate of Erickson v. Comr., T.C. Memo 2007-107 (4/30/07)*, decedent was diagnosed with Alzheimer's disease in 1999 at age 86 and in 2000 moved to a supervised living facility. After an analysis indicated that decedent's estate would owe over $500,000 of estate taxes, decedent's daughter, her agent under a durable power of attorney, formed a family limited partnership.

The partnership agreement was signed in May 2001 but was not funded for more than two months. Daughter and a second daughter contributed property in exchange for the general partner interests and daughter, as decedent's agent, transferred decedent's securities to the partnership for a limited partnership interest. On September 28, 2001, decedent entered the hospital with pneumonia, and on the same day, daughter (i) as her agent, transferred decedent's condominium to the partnership, (ii) as co-trustee of a credit shelter trust created for decedent by decedent's late husband, transferred the trust's condominium to the partnership, and, (iii) as decedent's agent, made gifts of all but 24.18% of decedent's limited partnership interests. Decedent died two days later. During the administration of her estate, the partnership provided needed funds to the estate.

On the basis of these facts the Tax Court held that the assets decedent transferred to the partnership were included in her estate under Code Sec. 2036(a)(1), finding that (i) the parties had an implied agreement that decedent would retain possession and enjoyment of the assets transferred to the partnership, and (ii) the transfers were not bona fide sales.

In finding an implied agreement, the court noted: (i) the parties' delay in funding the partnership, (ii) the number of transfers made to the partnership and gifts of decedent's limited partnership

continued on Page 28

interests when decedent's death was imminent; (iii) the availability of funds to decedent or her estate, (iv) the estate received funds when no other partners did; (v) the partnership had little practical effect during decedent's life, and (vi) the partnership was mainly an alternate method through which decedent could provide for her heirs.

In finding no bona fide sale for adequate and full consideration, the court noted that the parties did not form the partnership for legitimate and significant nontax reasons because (i) decedent's age and declining health reinforced the finding that the parties formed the partnership to reduce the decedent's estate tax liability, (ii) the partnership was mainly a collection of passive assets with the same managers as before the transfer and daughter, as agent under a power of attorney, already had significant management responsibilities for family assets, (iii) facilitating gift giving is not a significant nontax purpose; (iv) the parties delayed funding the partnership until the decedent's death was imminent, (v) the estate was financially dependent on the partnership, and (vi) daughter formed the partnership unilaterally and stood on every side of the transaction and the same law firm represented all parties.

Remittance Refunded to Taxpayer

In *Huskins, 75 Fed. Cl. 659, 99 AFTR2d 2007-1728 (Ct. Fed. Cl., 2007)*, the decedent died on September 22, 1998, with an estate consisting of real estate in Florida, a condo in New York and an interest in a mortgage note on real estate in New York. The mortgage note was difficult to value because it was the subject of multiple lawsuits and as a result, the estate was unable to file an estate tax return by the due date.

In order to sell the New York real estate, the estate deposited into an escrow account $165,000, believed to be sufficient to cover the estate's tax liabilities; following the sale of the New York real estate, the attorney for the estate in May 2000 remitted the escrowed funds to the Service with a cover letter stating that "this payment is to be applied" to the decedent's estate taxes.

After the litigation regarding the mortgage note had been resolved, the estate tax return was filed in November 2004 reporting no tax due after the application of allowable deductions and credits. Following receipt of the closing letter confirming that no estate tax was due, the estate's attorney wrote to the Service regarding the estate's refund and was informed that a refund had been denied because the return was filed more than three years after the payment was made.

The Court of Federal Claims which heard this case first noted that Code Sec. 6511(a) requires that a refund claim be filed either within three years of the filing of the return or within two years of payment, whichever is later. However, Section 6511(b)(2)(A) limits the amount that may be refunded to the portion of the tax paid within three years prior to the filing of the refund claim. Because the estate sent the check in May 2000, the latest that the estate could have filed a timely claim for refund would have been May 2003; the estate filed the return, which constituted the claim for refund, in November 2004, and therefore the claim was filed a year and half too late. Nevertheless, this conclusion would follow only if the remittance in May 2000 was a "payment of tax" rather than a tax deposit.

Both the Service's and the estate's initial arguments concerned the extent to which Rev. Proc. 84-58 applied; this Rev. Proc. sets forth procedures for taxpayers to follow if they wish a remittance to constitute a deposit rather than a payment of tax. A deposit, unlike a payment, is not subject to the limitations regarding refunds. The court found in this case that the estate did not make the remittance in response to a proposed liability and, based on Rev. Proc. 84-58, concluded that the remittance was a deposit, not a payment, and accordingly the taxpayer was entitled to a refund because deposits are not subject to the limitations applicable to refund claims.

As evidence that a deposit was intended, the court cited the following factors: (i) the remittance was made by the taxpayer voluntarily and before a tax return was filed and the remittance was not made in response to an assessment, proposed deficiency, or notice of deficiency by the Service, (ii) the remittance was "disorderly" because the calculation of the estate's tax liability made by the attorney for the estate was not based on a good faith estimate of taxes that would ultimately be due since the calculation excluded allowable deductions and the value used with respect to the mortgage note was not based on the probable outcome of the litigation, (iii) the estate intended the remittance as a deposit evidenced by a letter sent by the attorney for the estate to the personal representative of the estate four days after the attorney forwarded the check to the Service in which the attorney refers to the remittance as a "deposit against federal estate tax."

continued on Page 29

Tax Update, continued

Ohio District Court Finds Annuity Tables Result in Unrealistic Value to Future Lottery Payments

In *Negron v. U.S.,* 99 AFTR 2d 2007 -1047 (ND Ohio, June 4, 2007), the two decedents and one other person jointly won a 1991 lottery prize payable in 26 annual payments that could not be assigned or used as collateral. Both decedents died in 2001. Federal estate tax returns for both estates were filed in 2002, reporting the value of the 15 remaining annual lottery payments due to each decedent at $2,275,867, based on the amount each estate was to receive as a lump sum distribution from the state lottery commission, which used a 9% discount rate. Each estate actually received $1,547,045 after withholdings for federal and state income taxes.

The Service audited and determined that the value of each estate's remaining lottery payments was approximately $2.7 million, based on the Code Sec. 7520 annuity tables. After paying the resulting increase in estate taxes and filing refund claims which were denied, the estates filed suit.

On the basis of these facts, the district court (which is in the Sixth Circuit) held that the Code Sec. 7520 annuity tables produce an unrealistic and unreasonable value for the estates' annuity payments. The court rejected the view of the Fifth Circuit, in *Cook Est. v. Comr., 349 F.3d 850 (5th Cir. 2003)* which concluded that lottery annuity payments are properly valued by reference to the Code Sec. 7520 annuity tables. The court concluded that it was more convinced by the Second and Ninth Circuits, in *Gribauskas Est. v. Comr., 342 F.3d 85 (2d Cir. 2003)*, and *Shackleford v. U.S., 262 F.3d 1028 (9th Cir. 2001)*, which held that the Code Sec. 7520 annuity tables do not accurately reflect the value of future lottery payments because the tables fail to account for the annuity's lack of marketability. The court ordered further proceedings to allow the estates to establish a more realistic and reasonable means to determine the value of the annuity.

New Hampshire District Court Applies Actuarial Tables in Valuing Future Lottery Payments

In *Davis v. United States, 2007 WL 1697104 (June 13, 2007)*, the District Court in New Hampshire came to the opposite conclusion as the court in *Negron v. U.S.* In this case, the decedent had won the Massachusetts lottery, and at his death, was entitled to receive ten more annual payments. The decedent's estate valued the remaining payments under the Code Sec. 7520 actuarial tables, and then sued for a refund, claiming that the value of the lottery annuity should be reduced to reflect the lack of marketability because the annuity could not be assigned, sold or used as collateral.

On the basis of these facts, the district court held that the estate had not proven that the actuarial tables resulted in unreasonable figures. The court rejected the estate's appraiser's 50% discount for lack of marketability which relied on the theory that the estate tax value should assume that the risk a hypothetical buyer would take, relying on the estate to continue receiving the payments and remitting them to the buyer. The court disagreed that there was a risk and rejected the view of *Gribauskas Est. v. Comr., 342 F.3d 85 (2d Cir. 2003)* and *Estate of Shackleford v. U. S., 262 F.3d 1028 (9th Cir., 2001)*. The court followed *Cook Est. v. Comr., 349 F.3d 850 (5th Cir. 2003)*, holding that the greatest discount that would be justified was 5%, which did not render the actuarial valuation unreasonable.

Estate Cannot Take a Charitable Deduction for Trust With Both Charitable and Noncharitable Residual Beneficiaries

In *Galloway v. U.S., No. 06-3007 (3d Cir. 6/21/07)*, decedent's revocable trust provided that, following his death which occurred in 1998, the residue was to pass in four equal shares to decedent's son, decedent's granddaughter, and two charities. One half of each residual beneficiary's share was received in 2006 and each beneficiary will receive the balance in 2016. If an individual beneficiary is not living at the time of the final distribution, his or her share will be distributed to the other beneficiaries. If both individual beneficiaries are not living, the entire balance will pass to the two charities.

The estate claimed an estate tax charitable deduction under Code Sec. 2055(a) for the amount it anticipated would ultimately pass to the two charities. The Service denied the deduction on the basis that the trust was a split-interest trust for which no deduction was allowed under Code Sec. 2055(e)(2). After the Service rejected the estate's refund claim, the estate filed suit. The district court upheld the Service's position and the estate appealed.

The Third Circuit affirmed, holding that Code Sec. 2055(e) prevents an estate from claiming a charitable deduction when distributing the proceeds of a single trust to both charitable and noncharitable residual beneficiaries. The court found that when the deduction was claimed in 2000, the charitable and noncharitable

continued on Page 30

Tax Update, continued

beneficiaries retained an interest in the same property; at the time of the claimed deduction the charitable and noncharitable beneficiaries had an interest in the same property, and Code Sec. 2055(e) precluded any deduction for the charitable beneficiaries' interests in that property.

Partial Interest in Artwork Valued

In *Stone v. US, 99 AFTR 2d 2007-1 (ND CA May 25, 2007)*, decedent's estate tax return valued decedent's one-half 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.

On the basis of these facts, a California district court upheld the Service's total appraisal, the values of the two paintings at issue having been determined by the IRS Art Advisory Panel. The court then held 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. The court determined that the estate was instead entitled to a cost-to-partition discount, including the fees associated with bringing a legal partition action, the actual costs of selling the collection at auction and for the uncertainties involved due to the delay of a sale until a hypothetical partition action is resolved. The court then directed the parties to negotiate further to calculate an appropriate discount upon which both parties could agree.

Father's Loan to a Trust For Daughter's Benefit Deductible as a Bona Fide Loan

In *Hicks Est. v. Comr., T.C. Memo 2007-182 (7/10/07)*, daughter at a young age was involved in a car collision with a train which left her a quadriplegic, dependent on a ventilator to breathe, and in need of constant medical attention for the rest of her life. Her parents had very good health insurance that was paying for almost all of her medical expenses, with no lifetime cap, but the policy would continue only as long one of daughter's parents continued to work for the state government. Knowing that it was possible they might not always have this coverage or that they might not survive daughter, litigation followed, and eventually a $4,650,000 settlement was reached. As a result of the settlement and with court approval, two trusts were created for daughter:

1. A special needs trust, complying with §1396p(d)(4)(A) of the Medicaid Payback Trust Act and to be funded with $1 million from the settlement.

2. A Settlement Fund Management Trust, to be available for daughter's support, maintenance, health, and education, to be funded in part by another $450,000 from the settlement. The assets of this trust would be counted in determining daughter's Medicaid eligibility and if the insurance coverage she had through her parents lapsed, she would have to spend all or nearly all of the Management Trust's assets in order to be eligible for Medicaid. Father funded a substantial part of this trust with a loan of $1 million to be allocated to him from the settlement. The loan was evidenced by a demand promissory note, with interest as 6% per annum from the trust to him. The note was callable on demand in two circumstances, either daughter's death or her failure "to have available at reasonable premium charges a commercial medical indemnity contract" once she turned eighteen.

The state probate court with jurisdiction under state law, reviewed and approved the settlement, allocations, and distribution of noneconomic compensatory damages. The court gave over $1.4 million from the lump-sum settlement to father, but with the full expectation that he would immediately lend $1 million to the Management Trust; the bank that had been appointed as guardian of daughter's estate for the litigation and trustee of this trust issued a promissory note to father for $1 million. For several years, father received interest on schedule, and duly reported it on his income tax return each year. Following daughter's death at age 11, the estate listed the total amounts in both trusts and then claimed as a deductible debt under Code Sec. 2053(a)(3) and (a)(4) the $1 million owed to father under the promissory note. The service disallowed the deduction as not being bona fide.

On the basis of these facts, The Tax Court held that the estate was entitled to deduct $1 million as a repayment of a loan that was bona fide and for full and adequate consideration under Code Sec. 2053(c)(1)(A). Contrary to the Service's position that father never had a real interest in the $1 million, the court noted that the state probate court had to approve any settlement which the minor's guardian reaches before it can take effect and

continued on Page 31

Tax Update, continued

therefore the $1 million in question did not belong to anyone until the probate court said it did. The court noted that (i) all the parties to the trust arrangement intended that the loan would be repaid if either of the stated conditions were met, (ii) the note was executed and admitted into the record, and (iii) that father was paid interest every month on the principal amount of the loan.

The Tax Court found that the present value of father's income interest in the note was likely to be substantial. There was a real risk that father would predecease daughter, and if he did, the present value of the note would become part of his taxable estate. In response to the Service's argument that the allocation as a whole lacked real economic substance, the Tax Court found that father's loan had real substance; it was valid under state law, and resulted in the creation of real income interest on which father actually paid tax.

III. IRS REVENUE RULINGS, REVENUE PROCEDURES & NOTICES

Service Reconsidering Effect of Trust Distributions Made By Committee of Beneficiaries

In *IRS News Release IR-2007-127 (7/9/07)*, the Service announced that it is reconsidering a series of private letter rulings issued under Code Sec. 2514 and 2511 that involved trusts that used distribution committees consisting of trust beneficiaries who direct distributions of trust income and principal. The rulings on the application of Code Sec. 2514 might not be consistent with *Rev. Rul. 76-503, 1976-2 C.B. 275* and *Rev. Rul. 77-158, 1977-1 C.B. 285*. The Service has requested comments on whether the Code Sec. 2514 rulings in the private letter rulings can be reconciled with these revenue rulings.

The private letter rulings involved trust distributions made either upon the unanimous consent of a distribution committee consisting of trust beneficiaries or at the discretion of an individual committee member with the consent of the trust grantor. If a distribution committee member dies or resigns, the member is replaced. The private letter rulings each concluded that the committee members have substantial adverse interests to each other for purposes of Code Sec. 2514 and, therefore, the beneficiaries do not possess general powers of appointment over the trust, and the trust distributions are not subject to gift tax as to the committee members.

However, *Rev. Ruls. 76-503* and *77-158* indicate, in similar circumstances, co-trustees are treated as possessing general powers of appointment where they are replaced if they resign or die. It has been suggested that the private letter rulings can be distinguished from the revenue rulings on the basis that the grantor's gift to the trust in the private letter rulings is incomplete because the grantor retains a testamentary special power of appointment.

Before taking any action on the private letter rulings, the Service has requested comments on whether the distribution committee members possess general powers of appointment under Code Sec. 2514 and suggestions for a substantially similar trust structure that would achieve the intended income, gift, and estate tax objections of the transactions described in the private letter rulings.

IRS Explains Expanded Income Tax Benefits for Conservation Contributions

In *Notice 2007-50, 2007-25 IRB 1430 (June 18, 2007)*, the Service outlines in the form of questions and answers the income tax deduction rules applicable to qualified conservation contributions made in calendar years 2006 or 2007 which were increased by the Pension Protection Act of 2006. The amount of charitable contributions that an individual may deduct in a tax year was increased from 30% of the contribution base to 50% and the carryover period for unused deductions was extended from 5 years to 15 years. There is a 100% deduction available to contributors who are farmers or ranchers but this only applies to contributions made after August 17, 2006, and only if the property is required to remain available for agriculture or livestock production.

IRS Provides Sample Forms for Charitable Lead Annuity Trusts

In *Rev Proc 2007-45, 2007-29 IRB*, and *Rev Proc 2007-46, 2007-29 IRB*, the Service has issued two revenue procedures containing annotated sample declarations of trust and alternate provisions that meet the requirements for a charitable lead annuity trust.

Rev Proc 2007-45, Sec. 4. provides a sample declaration of trust for a *nongrantor charitable lead annuity trust* with a term of years annuity period; Sec. 5. provides annotations to the provisions of the sample trust; and Sec. 6. provides samples of alternate provisions. The value of the charitable lead interest will be deductible under Code Sec. 2522(c)(2)(B) or Code

continued on Page 32

Sec. 2055(e)(2)(B), and payments of the annuity amount to the charitable lead beneficiary will be deductible from the gross income of the trust to the extent provided by Code Sec. 642(c)(1) if a trust (i) is substantially similar to the sample trust or properly substitutes one or more alternate provisions in a document substantially similar to the sample trust; (ii) is a valid trust under applicable local law; and (iii) operates in a manner consistent with the terms of the instrument and all other requirements for deductibility are satisfied.

Rev Proc 2007-45, Sec. 7. provides a sample declaration of trust for a *grantor charitable lead annuity trust*; Sec. 8. provides annotations to the provisions of the sample trust; and Sec. 9. provides samples of alternate provisions. Use of this sample and alternate provisions can assure deductions under conditions that are similar to those that apply with respect to the nongrantor trusts.

Rev Proc 2007-46, Sec. 4. provides a sample declaration of trust for a *testamentary charitable lead annuity trust* with a term of years annuity period; Sec. 5 provides annotations to the provisions of the sample trust; and Sec. 6 provides samples of alternate provisions. The value of the charitable lead interest will be deductible by the decedent's estate under Code Sec. 2055(e)(2)(B), and payments of the annuity amount to the charitable lead beneficiary will be deductible from the gross income of the trust to the extent provided by Code Sec. 642(c)(1) if a trust (i) is substantially similar to the sample trust or properly substitutes one or more alternate provisions in a document substantially similar to the sample trust; (ii) is a valid trust under applicable local law; and (iii) operates in a manner consistent with the terms of the instrument and all other requirements for deductibility are satisfied.

Each of the above charitable lead annuity trusts will qualify for its respective safe harbor if it satisfies the above requirements but it defines the annuity amount as an increasing amount for which the value is ascertainable at the creation of the trust or provides for a different disposition of trust assets on the termination of the annuity period.

IV. IRS PRIVATE LETTER RULINGS AND TECHNICAL ADVICE MEMORANDA

Transfer to Trust Not a Completed Gift

In *PLR 200715005*, a trust created by grantor provides that during grantor's lifetime, the trustee may distribute trust income or principal to grantor, grantor's brother, and grantor's descendants, as either (i) a distribution committee agrees, or (ii) one member of the distribution committee and grantor agree. At grantor's death, the trustee is to distribute trust's principal as grantor appoints under a retained testamentary limited power of appointment, not exercisable in favor of grantor, grantor's estate, grantor's creditors, or the creditors of grantor's estate. To the extent grantor fails to exercise the power, the trustee is to hold the trust remainder for grantor's surviving descendants.

During grantor's lifetime, the committee must have at least two members (who must also be trust beneficiaries but cannot be grantor or grantor's spouse). The initial committee is grantor's brother and grantor's child; if either of them becomes unable to act, grantor's son will fill the first vacancy. The oldest beneficiary will fill any further vacancy.

The Service ruled that nothing in the facts as presented would cause grantor or any other person to be treated as the owner of any portion of the trust under Code Secs. 673, 674, 676, 677, or 678; the application of Code Sec. 675 is a factual matter that must be determined by the trust operation and, therefore the Service deferred ruling on that issue.

The Service next ruled that grantor's transfer of property to the trust will not be a completed gift for gift tax purposes in view of grantor's retained testamentary power of appointment over trust principal and accumulated income. Regs. §25.2511-2(b) provides that a donor's transfer of property to a trust giving the trustee discretion to accumulate income or pay it to the donor and over which the donor retains a testamentary power to appoint the remainder to his or her descendants is a wholly incomplete transfer. Regs.. §25.2511-2(f) provides that a donor's inter vivos relinquishment or termination of a power to change beneficiaries of transferred property completes the gift and causes the gift tax to apply.

Finally, the Service ruled that, during the period that the distribution committee consists of brother and child, neither brother nor child will be treated as making a taxable gift if trust income or principal is distributed to grantor under the trust terms. In this case, the Service noted, brother and child (as the distribution committee) have the power to appoint trust income and principal to themselves. However, the Service observed that each one's power is only exercisable

continued on Page 33

Tax Update, continued

with the other's consent and that, on either's death, the decedent's power will devolve to the survivor and grantor's son jointly. Under Code Sec. 2514(c)(3)(B), a power is not a general power if the power holder can exercise the power only in conjunction with another person who has a substantial interest in the property subject to the power that is adverse to the exercise of the power in the power holder's favor. Thus, the Service concluded, brother and child will not have a general power of appointment via their joint distribution power.

Renunciation of QTIP interests will result in gifts under Code Secs. 2519 and 2511.

In *PLR 200717016*, the residue of decedent's estate was divided into a QTIP trust for his spouse (for which a QTIP election was made on the estate tax return) and a non-marital trust. Spouse, a bank, and two other individuals are trustees of the QTIP trust. The trustees sought a court order (i) dividing the QTIP into two separate identical trusts, QTIP1 and QTIP2, each of which were funded on a non-pro-rata basis; and (ii) making the bank the sole trustee of QTIP2 (which was further divided into two trusts). Spouse plans to renounce her right to receive income and discretionary principal distributions from QTIP2.

On the basis of these facts, the Service ruled that the proposed division of the QTIP trust into QTIP1 and QTIP2, the funding on the trusts on a non-pro-rata basis, and spouse's renunciation of her entire interest in QTIP2 will not invalidate the QTIP election or the QTIP trust status for any of the trusts. The Service further ruled that if spouse renounces her qualifying income interest in QTIP2:

a. She will be deemed to have made a Code Sec. 2519 transfer of all of QTIP2 other than her income interest. However, such renunciation will not result in a Code Sec. 2519 transfer of any QTIP1 assets. In addition, the transfer of the qualifying income interest is a gift under Code Sec. 2511.
b. Spouse will be personally liable for all gift tax attributable to the transferred property, except that spouse will be deemed to have made a net gift if she exercises her Code Sec. 2207A(b) right to recover gift taxes paid on the transferred property.
c. No part of the trust's property deemed transferred under Code Sec. 2519 will be included in her estate under Code Sec. 2044(b)(2).
d. Spouse's interest in QTIP1 will not be valued at zero under Code Sec. 2702.
e. None of the property of QTIP2 will be included in spouse's estate under Code Sec. 2036, Code Sec. 2037, or Code Sec. 2038.

Request For Extension of Time to File Code Sec. 6166 Election Denied

In *PLR 200721006*, the personal representative of an estate timely filed Form 4768 to request an extension of time to file the federal estate tax return. Form 706 was subsequently filed along with a request for an election under Code Sec. 6166. The Service denied the election because it was not timely filed.

The personal representative requested an extension of time under Reg. §301.9100-3 to file the Code Sec.6166 election; alternatively, the personal representative, requested that the Code Sec. 6166 election be considered a procedural directive and granted on the basis of the "substantial compliance doctrine." The Service denied the request on the basis that Reg. §301.9100-3 applies only to regulatory elections and not statutory elections, and an election under Code Sec. 6166 is a statutory election.

The Service explained that under Code Sec. 6166(d), the election must be made no later than the time prescribed by Code Sec. 6075(a) for filing the estate tax return; Code Sec. 6075(a) states that such returns must be filed within nine months after the date of the decedent's death. Because the due date for an election under Code Sec. 6166 is prescribed by statute, the election is by definition a statutory election within the meaning of Reg. §301.9100-1(b).

While Reg. §20.6166-1(b) states the election provided under Code Sec. 6166(a) is made by attaching certain information to a timely filed estate tax return, Code Sec. 6075 prescribes what makes an estate tax return timely. The Service found that the due date cannot be determined without reference to statute; the incorporation of a statutory due date in a regulation does not change a statutory election into a regulatory election, and therefore, Reg. §301.9100-3 does not apply in this case.

In addition, the Service found that the "substantial compliance" doctrine does not apply in the context of making an election under Code Sec. 6166.

continued on Page 34

No Gift on Sale of Personal Residence

In *PLR 200728018*, husband and wife own property as tenants by the entireties that has been used exclusively as their second residence. They intend to subdivide the property and transfer one parcel, consisting of a certain acreage on which the main living quarters, a pool house, guest cottage, garage, and a barn are situated, to a personal residence trust meeting the requirements of Reg. §25.27025(b)(1)-(3). The trust will provide that the trustees will hold the parcel (or any property acquired as a replacement personal residence) as the sole asset of the trust for the exclusive, rent-free use of husband and wife as their personal residence during their joint lives and until the death of the survivor.

Husband has also established a second trust (the "Purchasing Trust"), the beneficiaries of which are husband's and wife's issue, except that the trustee has the power, until the death of the survivor of husband and wife to distribute trust corpus to one or more charities as the trustee determines. Pursuant to a written agreement, husband and wife will transfer the parcel to the personal residence trust, which names the Purchasing Trust as the remainder beneficiary in exchange for the transfer by the Purchasing Trust to husband and wife of cash and marketable securities that have an aggregate fair market value on the date of transfer equal to the value of the remainder interest in the personal residence trust based on the fair market value of the parcel on the date of transfer (as determined by an expert appraiser) and the general actuarial principles of Code Sec. 7520. Neither husband nor wife is suffering from any condition or illness such that there is at least a 50% probability that either husband or wife will die within one year.

Until the death of the survivor, all expenses of the parcel will be paid by husband and wife and the Purchasing Trust in the same manner in which expenses are borne by the holders of legal life estates and remainder interests under the applicable State law. Upon the death of the survivor, the parcel will be distributed to the Purchasing Trust.

On the basis of these facts, the Service ruled that: (i) the parcel constitutes a personal residence within the meaning of Code Sec. 2702(a)(3)(A)(ii) and Reg. §25.2702-5(b)(2); and (ii) the transfer of the parcel to the personal residence trust followed by the sale of the remainder interest to the Purchasing Trust (under the terms as outlined above) will not constitute a taxable gift by either husband or wife for federal gift tax purposes under Code Sec. 2501, the sale being for adequate and full consideration in money or money's worth. The Service specifically stated that it was not expressing an opinion as to whether the corpus of the personal residence trust would be includible in the gross estate of either husband or wife, or as to the fair market value of the parcel on the date it was contributed to the trust.