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Report of the Chair

By KEVIN P. GILBOY
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Thank you for the opportunity to serve as chair of the Probate Section this past year. As usual, the heavy lifting has been done by my fellow officers, members of the executive committee, committee chairs and committee members.

With Margie Thompson as the incoming chair and Bob Louis joining Rob Friedman and Nina Stryker as the Section's officers, the future of the Section is in good hands, although Bob's shoes will not be easy to fill as editor of this newsletter - I know I will miss his gentle reminders when this column was late.

Reflecting back on the past year, we spent much of our energy preparing for the full implementation of the Uniform Trust Act. The Education Committee had an instructive program in June to help us wade through the notice requirements of the Act. The Ad Hoc Committee on the Uniform Trust Act labored long and hard with the Pennsylvania Bankers Association and others to bring about technical corrections in the Uniform Trust Act; unfortunately, although the bill passed the Pennsylvania Senate, the crowded legislative calendar of this election year closed out just before the Pennsylvania House could take action on the bill. We expect a similar bill will be introduced in the new legislative session.

In any event, the November 6 trust notice deadline came and went and we are all (I hope) still standing. We now have to grapple with systems to let us know when

continued on Page 2

Inside this Issue....

Regarding the Power to Appoint Additional Trustees

By MARY-NOELLE RASI
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Does the I.R.S. require that the power to appoint additional Trustees be limited to non-related, non-subordinate parties, as defined in §672(c) of the Code, in order to avoid inclusion? Does the answer to the foregoing question vary depending upon whether the power is retained by the Settlor, held by a Trustee, or granted to a beneficiary?

This discussion arose last summer among several of my colleagues, when one questioned whether he could make a change to the standard language in an estate planning document limiting the appointment of additional Trustees to non-related and non-subordinate parties in the same fashion that the power to appoint replacement and named successor Trustees is so limited, as follows: "Settlor may in writing: (1) add additional Trustees, remove any Trustee then serving provided that such Trustee is replaced by Settlor, or replace any named successor Trustee not then serving, provided that each additional, successor or replacement Trustee who may serve during Settlor's lifetime is not a related or subordinate party, as defined in Section 672(c) of the Internal Revenue Code, to Settlor, and (2) fill any vacancy in the office of Trustee."

The proposed change would have moved the appointment of additional Trustees to the second clause of the foregoing sentence, thereby excepting it from the 672(c) limitation, to read as follows: "Settlor may in writing: (1) remove any Trustee then serving provided that such Trustee is replaced by Settlor, or replace any named successor Trustee not then serving, provided that each successor or replacement Trustee who may serve during Settlor's lifetime is not a related or subordinate party, as defined in Section 672(c) of the Internal Revenue Code, to Settlor, and (2) add additional Trustees and fill any vacancy in the office of Trustee."

The modification above removes the stipulation that an additional Trustee be a non-related and non-subordinate party. While it is well settled since *Estate of Wall*, 101 TC 300 (1993) and subsequent I.R.S. Rev. Rul. 95-58 that the Settlor's retained power to remove and replace Trustees with non-related, non-subordinate parties (as defined by 672(c)) is not deemed a reservation of a discretionary distribution power that would cause inclusion of trust assets in the Settlor's estate for estate tax purposes, the ensuing discussion revealed uncertainty regarding whether the I.R.S. had definitively addressed the issue of whether the power to appoint additional Trustees was limited to non-related and non-subordinate

continued on Page 3

Report of the Chair, continued

trust beneficiaries turn age twenty-five so that appropriate additional notices can be given. Other parts of the Uniform Trust Act will have to be fleshed out over time as courts decide what is a "material purpose" of a trust subject to a proposed modification or what is a "substantially similar interest" of a beneficiary subject to virtual representation.

A sign of the health of our Section is the re-establishment of estate planning lunch groups by younger members of our Section. These groups, aside from being fun, allow younger estate planning lawyers to exchange practice tips, use their colleagues as sounding boards and develop lifelong, rewarding professional relationships. Those of us who have been at this practice for some time appreciate how rewarding the practice is. The attractions of the probate practice are not always obvious to a young lawyer confronted with many choices. A possible silver lining of the current economic gloom is that the slow and steady (sometimes tortoise-like) estate planning practice again looks like an attractive career choice as compared to other formerly hare-like but now slowing practice areas.

The harder economic times should not distract us from our duty to help those who are less fortunate than we are. Our Section continues to do yeoman work in the tangled title and now the mortgage foreclosure diversion programs and I thank all of you who have contributed. But the needs are greater than ever and I ask each of you to donate some of your talents in these areas in the coming year.

Thanks again for the opportunity to be of service to the Section.

Trustees, continued

individuals, and whether the power to appoint a related or subordinate additional Trustee would trigger inclusion in the estate of the power holder under 2036(b)(1), 2038(a)(1) or 2041(a)(2).

In researching the issue, I found that the I.R.S. has not specifically addressed the question of whether the power to add additional Trustees must be limited to non-related and non-subordinate parties as defined in §672(c) in order to avoid inclusion in the estate of the power holder. I would hypothesize, however, that it must be so limited.

All examples I found (all Private Letter Rulings) in which the I.R.S. has ruled that the power to add additional Trustees does not trigger inclusion in the estate of the power holder have involved circumstances in which a related or subordinate Trustee is either barred by the terms of the trust from exercising discretionary authority regarding distributions from the trust, or, by its terms distributions from the trust are limited to an ascertainable standard. *See* I.R.S. Priv. Ltr. Rul. 9849005; *See* I.R.S. Priv. Ltr. Rul. 200449029; *See* I.R.S. Priv. Ltr. Rul. 200804015; and *See* I.R.S. Priv. Ltr. Rul. 200546055. I found no examples in which an additional Trustee was related or subordinate and had full power to exercise discretionary authority in administration of the trust.

A review of the various Private Letter Rulings in which a Settlor wishes to add an additional Trustee to a trust would imply that the additional Trustee may not be related or subordinate to the Settlor if the Settlor wishes to avoid inclusion of the trust assets in his or her estate. *See* I.R.S. Priv. Ltr. Rul. 200449029 (Aug. 11, 2004); *See* I.R.S. Priv. Ltr. Rul. 98-49-005 (Sept. 1, 1998). In one example, the Settlor of an irrevocable trust sought to modify the trust agreement to add a provision allowing him or other family members to control the removal and appointment of Trustees, and under the proposed modification, the Settlor would retain the power to appoint additional Trustees. I.R.S. Priv. Ltr. Rul. 200449029 (Aug. 11, 2004).

Significantly, by the terms of the proposed modification, no additional Trustee appointed by the Settlor could be related or subordinate to him. *Id.* Furthermore, the terms of the trust agreement prohibited the Trustees from making distributions which would discharge support obligations of the Settlor, and distributions of principal were limited to the education and maintenance in health and reasonable comfort of the beneficiaries. *Id.* Not surprisingly, the I.R.S. ruled that the Settlor had retained no right, title, interest in, or power over the trust property, and that the Settlor's retained power to appoint additional Trustees who were not related or subordinate would not result in the trust being includible in the Settlor's gross estate. *Id.* The negative implication, based on the I.R.S.'s consideration of the non-related and non-subordinate status of the additional Trustees and the attendant limitation of their discretionary powers, is that had these factors been different, the I.R.S. might have ruled otherwise.

Another Private Letter Ruling, in which the Trustees of an irrevocable trust sought to establish a successor trust, was decided similarly. Under the terms of the successor trust the Trustees sought to establish, the Settlor could appoint additional Trustees; however, if the Settlor appointed an additional Trustee who was related or subordinate to him, as defined by Section 672(c), that Trustee was prohibited from participating in the exercise of any discretionary authority. I.R.S. Priv. Ltr. Rul. 98-49-005 (Sept. 1, 1998). Moreover, if a Trustee who did have discretionary authority was removed by the Settlor, that Trustee's replacement was limited to a non- related, non- subordinate individual. *Id.* The Trustees of the original trust sought to transfer the principal of the original trust into the successor trust, and requested a ruling that the proposed transaction would not result in a change in the inclusion ratio for purposes of the generation-skipping transfer tax with respect to the successor trust, and the I.R.S. so ruled. The inclusion ratio of the successor trust remained the same as that of the original trust, that is, zero. *Id.*

In a Private Letter Ruling regarding a situation in which three Trustees who are also beneficiaries of the subject trust wish to add additional Trustees, the I.R.S. has implied that an additional Trustee who may exercise the authority to make discretionary distributions of trust principal may not be related or subordinate to a Trustee who is also a beneficiary, if the appointing Trustee who is also a beneficiary wishes to avoid inclusion of the trust assets in his or her estate. *See* I.R.S. Priv. Ltr. Rul. 200804015 (Oct. 4, 2007). In that case, the Trustee who was also a beneficiary sought to modify the subject trust by dividing it into three separate sub-trusts, adding a provision that each of the three Trustees would serve as the sole Trustee of his or her own sub-trust, with a power to appoint and remove Trustees of the sub-trust. Id. Under the terms of the trust agreement, if a Trustee who was a beneficiary appointed a co-Trustee who was a related or subordinate party, the co-Trustee was restricted from exercising the authority to make discretionary distributions of trust principal. *Id.* The discretion-

continued on Page 4

Trustees, continued

ary authority to distribute trust principal to the beneficiaries would be exercised by a special Trustee who was not related or subordinate to the beneficiaries, and who was appointed for the sole purpose of making such discretionary distributions. Here, again, the I.R.S. ruled that in light of the restriction on a related or subordinate Trustee's authority to make discretionary distributions, the powers retained by the Trustees who were also beneficiaries were not unlimited, and therefore the assets of each sub-trust were not includible in the gross estate of each of the Trustees who were beneficiaries of the sub-trusts. *Id.*

In editorial commentary on the risks inherent in trust administration, commentators consistently recommend that the power to make discretionary distributions be placed in the hands of the adverse party or independent Trustee. *See* "Powers to Replace Trustees: A Key Element of (and Risk to) Dynasty Trusts," Robert A Vigoda, Esquire (June 2008); *See* "Estate Tax Effects of Intentionally Defective Settlor Trusts," L.S. McCullough, Esquire (June 1998).

It is my conclusion, based on an overview of the various authorities dealing with the closest analogous circumstances (albeit not exactly on par with the question presented), that the I.R.S.'s consideration of whether an additional Trustee is a related or subordinate party in ruling on issues of inclusion would indicate that the status of the additional Trustee is indeed a factor in determining whether a power that could cause inclusion was retained. And, I would query, as a policy consideration, could it conceivably be the intent of the Service that a Settlor or Trustee who is also a beneficiary be able to accomplish, by appointing one or more related or subordinate additional Trustees, that which the same Settlor or Trustee is prohibited from accomplishing when appointing Trustees in the first instance? I would surmise that it is not.

Organizational Chart of Research Findings

Authority	**Inclusion?**	**Power Holder**	**Power**
Rev. Rul. 95-58	NO	Settlor	Remove/ Replace/Substitute non-related, non-subordinate
P.L.R. 200449029	NO	Settlor	Add non-related, non-subordinate Trustees. Distributions subject to ascertainable standard.
P.L.R. 9849005	NO	Settlor	Add related, subordinate Trustees who could not participate in exer cise of discretionary authority.
SAME	NO	Settlor	Remove/ Replace/Substitute non-related, non-subordinate
P.L.R. 200804015	NO	Trustee and Beneficiary	Add related, subordinate Trustees who could not participate in exer cise of discretionary authority.
SAME	NO	Independent Trustee	Exercise discretionary authority to appoint property to Trustees who are also beneficiaries.
P.L.R. 200546055	NO	Trustee	Add related, subordinate Trustees who could not participate in exer cise of discretionary authority; by the terms of the trusts Trustees have no discretionary power (other than investment power) not limited to an ascertainable standard.

Freeman-Whitted v. Beverly Enterprises

By BENJAMIN K. RODGERS
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In *Freeman-Whitted v. Beverly Enterprises*, the decedent named her son as agent under a durable power of attorney. *Freeman-Whitted v. Beverly Enterprises*, 28-10 Fiduciary Reporter 2d, Allegheny County 2008. A preliminary objection by the defendants raising an agreement for alternative dispute resolution involved the issue of whether "the holder of a power of attorney which empowers the holder to authorize the principal's admission to a medical, nursing, residential, or similar facility and enter into agreements for the principal's care has the power to execute, on behalf of the principal, an arbitration agreement that is not a precondition to admission…"

On the date of the decedent's admission to the nursing facility, her agent signed an admission agreement as well as a separate "resident and facility arbitration agreement," which was intended to govern all claims arising out of any service or health care provided to the resident by the facility. The arbitration agreement clearly stated that it was not a condition of admission or a precondition to the furnishing of services to the resident.

Defendants contended that the agent was authorized to execute the arbitration agreement under a provision of the power of attorney that tracked verbatim the language of 20 Pa. C.S. §5602(a)(8), which permits a principal to empower her agent "[t]o authorize my admission to a medical, nursing, residential or similar facility and to enter into agreements for my care." The court observed that these powers, as defined in 20 Pa. C.S. §5603(h), are confined to the agent's execution of any consent or admission forms required by such facility.

The court drew a distinction between the forms executed by the agent for the decedent's admission to the facility and the separately executed arbitration agreement waiving the decedent's right to litigate her claims in court. The arbitration agreement, the court held, did not involve the care of the principal and therefore the agent was without authority under §5603(h) to execute it. Because the power of attorney contained no other provision authorizing the agent to execute such an agreement, defendants' preliminary objection raising an agreement for alternative dispute resolution was overruled.

The court recognized in a footnote that this case did not involve a health care power of attorney under the Health Care Agents and Representatives Act, 20 Pa. C.S. §§5451-5465, and that the power of a health care agent under §5456(a) is cast in somewhat broader language.

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"Am I My Brother's Keeper? And My Sister's, My Granddaughter's, My Third Cousin's…" The Pennsylvania Uniform Trust Act's Virtual Representation in the Real World

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INTRODUCTION

Pennsylvania enacted the Uniform Trust Act (the "UTA"), 20 Pa. C.S. §§ 7701-7799.3, generally effective 11/6/06, adopting a customized version of the Uniform Trust Code (the "UTC"). With the adoption of the UTA came several significant changes to Pennsylvania trust law. Although the UTA has arguably made it easier to administer and modify trusts, often the ability to do so is contingent upon the consent of all beneficiaries. A beneficiary is defined as a person that "(1) has a present or future beneficial interest, vested or contingent; or (2) in a capacity other than that of trustee or protector, holds a power of appointment over the trust property." 20 Pa. C.S. §7703. Such a broad definition of "beneficiary" encompasses any contingent beneficiary, no matter how remote. How, then, can the consent of all beneficiaries be obtained when there are times when some beneficiaries are minors or, worse yet, not all beneficiaries have even been born?

The answer lies in the UTA's new virtual representation rules, found in Subchapter C of Chapter 77 ("Subchapter C"). 20 Pa. C.S.§§ 7721-7726. The UTA's virtual representation law is a heavily modified and customized version of Chapter 3 of the UTC (UTC §§ 301-305) and provides detailed rules under which a person, or class of persons, can represent minor, unborn, unknown or unascertained beneficiaries. This article summarizes the relevant provisions of the virtual representation law of the UTA and discusses how these provisions may be applied in everyday practice.

OVERVIEW OF SUBCHAPTER C

Pa C.S. §§ 7721 & 7722

In general, the virtual representation rules of Subchapter C apply to the entire UTA. 20 Pa. C.S. §7721(a).[1] Subchapter C applies to "trust matters" in judicial and nonjudicial proceedings. §7722. A "trust matter" includes nonjudicial settlement matters covered under §7710.1(d) and judicial proceedings. §7721(b).

In a judicial proceeding involving a trust matter, a court decree will be binding on the representative and the person and/or class of persons being represented if: (1) the trustee notifies the representatives in writing whom they represent; (2) the representative does not decline the representation; and (3) the representative acts in good faith. §7722(a). In a nonjudicial proceeding, "notice to, the consent or approval of or the waiver or release by" a representative will be binding on the person and/or class of persons if: (1) the trustee notifies the representatives in writing whom they represent; (2) the representative does not decline the representation; and (3) the representative acts in good faith. §7722(b).

Pa. C.S. §7723

§7723 makes up the majority of Subchapter C and details when a party may represent another party. With the exception of §7723(7), concerning the holder of certain powers of appointment, a person can represent another only to the extent that "there is no conflict of interest with respect to the matter at issue between the representative and the person or persons represented that might affect the impartiality of the representative." §7723. In addition, to the extent that a person

continued on Page 7

[1]Unless otherwise specified, all section references are deemed to be references to Title 20 of the Pennsylvania Consolidated Statutes (20 Pa. C.S.).

PA UTA, continued

is representing two or more persons, there can be no conflict of interest between the persons being represented that might affect the impartiality of the representative. Id.

The following are the nine categories under which someone may represent another person or persons:

"(1) A plenary guardian represents the person whose estate the guardian supervises, and a limited guardian represents the person whose estate the guardian supervises within the scope of authority prescribed by the court order that defines the guardian's authority." §7723(1)

"(2) An agent under a general power of attorney represents the agent's principal, and an agent under a limited power of attorney represents the principal within the scope of the agent's authority under the power of attorney." §7723(2)

Note that under both subsections (1) and (2), if a guardian or an agent has only limited authority to act on behalf of the ward/principal, the guardian/agent can only represent the ward/principal if it is within the scope of his or her authority to do so. For example, if a guardian is appointed for a minor only concerning Trust Account A, she could not virtually represent the minor in a judicial proceeding to modify Trust Account B.

"(3) Where property or an interest in property is vested in a class of persons, the living sui juris class members represent the class members who are minors, unborn, unknown or unascertained." §7723(3).

Under §7723(3), all sui juris current beneficiaries can represent minor, unborn, unknown or unascertained current beneficiaries. For example, assume that Testator died unmarried and, as a result of his death, a testamentary trust was created pursuant to Testator's will (the "Trust"). Testator had three children, Child A, Child B and Child C, all of whom are over 18. Child A is alive has no children. Child B is alive and has 3 children, Grandchild V, who is over 18, and Grandchild W and Grandchild X, both of whom are minors. Child C predeceased Testator and had 2 children, Grandchild Y and Grandchild Z. Grandchild Y is over 18, but Grandchild Z is a minor.

Under the terms of the Trust, the trustees have the discretion to distribute income and principal to Testator's descendants until the death of the survivor of Testator's children. At that time, the remaining principal of the Trust is to be distributed per stirpes to Testator's then living descendants. If none of Testator's descendants are then living, the remaining principal will be distributed in accordance with the intestate laws of Pennsylvania.

The beneficiaries wish to petition the court to modify the Trust under §7740.1(b) in order to change certain trustee provision.[2]

The current permissible beneficiaries of the Trust are Testator's descendants. Thus, assuming there is no conflict of interest, under §7723(3), Settlor's sui juris descendants (Child A, Child B, Grandchild V and Grandchild Y) represent all minor grandchildren (W, X and Z) as Testator's unborn descendants because, once they are born, they will become part of the class to whom income and principal may be paid. Note, however, that §7723(3) would only apply in this hypothetical to the current permissible income and principal beneficiaries; it would not apply to any of the contingent remainder beneficiaries.

[2]§7740.1 permits the court to modify a noncharitable irrevocable trust "upon the consent of all beneficiaries only if the court concludes that the modification is not inconsistent with a material purpose of the trust."

"(4) Where property or 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. The class members entitled to represent other class members or potential class members are the persons who would take the property or interest in property if the future event had occurred immediately before the commencement of the judicial proceeding relating to the property or interest in property or immediately before the effective date of the nonjudicial resolution of the matter."

Under §7723(4), a sui juris contingent beneficiary can represent all minor, unborn, unknown or unascertained contingent beneficiaries of the same class. Using the same hypothetical presented above, once the survivor of Child A and Child B dies, the remaining principal will be distributed outright to Testator's descendants, per stirpes. Thus, Testator's grandchildren (V, W, X, Y and Z) are of the class of contingent beneficiaries who would take upon the termination of the Trust. Under §7723(4), Grandchild V and Grandchild Y would represent the minor grandchildren (W, X and Z) as well as all of Testator's potential unborn descendants as contingent remainder beneficiaries of the Trust.

continued on Page 8

PA UTA, continued

"(5) Where property or an interest in property will pass to a person, class of persons or both upon the occurrence of a future event, but the property or interest in property will pass to another person, class of persons or both upon the occurrence of an additional future event, the person, class of persons or both who would take upon the occurrence of the first event represents the person, class of persons or both who would take upon the occurrence of the additional event, provided their interests are identical or substantially similar for purposes of the particular trust matter. If a class of persons would take upon the occurrence of the first event, paragraph (4) applies to representation between or among the class."

Under §7723(5), a contingent beneficiary can represent more remote contingent beneficiaries. Note that representation §7723(5) is not limited to minor, unborn, unknown or unascertained beneficiaries; thus, a contingent beneficiary may represent more remote contingent beneficiaries even if the more remote contingent beneficiaries are sui juris. Using the same hypothetical, Testator's sui juris descendants (Grandchild V and Grandchild Y) will represent Testator's intestate heirs (who will take if all of Testator's descendants die before termination), even if those intestate heirs are adults.

"(6) A person represents all minors or unborn individuals and persons whose identity or location is unknown and not reasonably ascertainable, to the extent such persons are not otherwise represented, if the interests of the person and the person represented are substantially identical with respect to the particular question or dispute involved."

§7723(6) appears to be a "catch-all" provision and is substantially similar to UTC §304 ("Unless otherwise represented, a minor, incapacitated, or unborn individual, or a person whose identity or location is unknown and not reasonably ascertainable, may be represented by and bound by another having a substantially identical interest with respect to the particular question or dispute, but only to the extent there is no conflict of interest between the representative and the person represented."). However, the comment to UTC §304 states that UTC §304 applies to situations such as a parent representing his or her child or a contingent beneficiary representing a more remote contingent beneficiary. These situations are addressed in the UTA under § 7723(9) and §7723(5), respectively. Thus, when §7723(6) would apply in the absence of representation under the other paragraphs of §7723 remains to be seen.

"(7) Whether or not there is a conflict of interest described in this section, the sole holder or all coholders of a presently exercisable or testamentary power of appointment represent all potential appointees and all takers in default of exercise of the power of appointment if the holder may appoint to:

(i) the holder's estate, the 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."

Under §7723(7), the holder of a general power of appointment or the broadest limited power of appointment (anyone other than the holder, the holder's estate, the holder's creditors and the creditors of the holder's estate) can represent all potential appointees (that is, anyone the holder can possibly appoint) and all people who would take if the holder does not exercise the power of appointment. Also note that the holder of such a power can represent all those classes regardless of whether there is a conflict of interest. This is the only paragraph in §7723 that permits representation if there is a conflict of interest between parties.

Using a different hypothetical, assume that Testator created a marital trust for her husband, giving him the net income for his life. The terms are silent about whether or not principal may be distributed to the husband. Upon the husband's death, the husband has the ability to appoint the principal to anyone other than the husband, his estate, his creditors or the creditors of his estate. If he does not exercise his power of appointment, the remaining principal will pass to Testator's descendants, many of whom are sui juris. The trustees and the husband wish to modify the trust to permit principal distribution for the husband's benefit during his lifetime. Under any other paragraph in §7723, the husband would not be permitted to virtually represent the remainder beneficiaries because there is a conflict of interest between the husband and the remainder beneficiaries -- if the modification is permitted permitting principal distributions to the husband during his lifetime, the remainder beneficiaries may receive less than they would receive if the trust is not modified. However, under §7723(7), the husband can represent Testator's descendants even though there is a conflict of interest between the husband and the descendants (assuming the sui juris descendants do not object under §7726 (discussed later)).

"(8) The sole holder or all coholders of a presently exercisable or testamentary power of appoint-

continued on Page 9

ment not described in paragraph (7) represent all potential appointees and all takers in default of exercise of the power who are also potential appointees."

If the power of appointment is limited beyond the holder, the holder's estate, the holder's creditors and the creditors of the holder's estate, the holder of the power can represent the potential appointees and those who would take if the holder does not exercise his or her power only if there is no conflict of interest.

Modifying the hypothetical described in §7723(7), assume that the husband only has the ability to appoint principal to any one or more of Testator's descendants. In this instance, the husband would not be able to represent the Testator's descendants (the takers in default of his exercise of his power of appointment) because there is a conflict of interest between the husband (who wishes to modify the trust to grant the trustees the ability to distribute principal to him) and the remainder beneficiaries (who may be deprived of principal if the modification is granted). Practitioners should take careful note to determine whether a power of appointment is limited beyond the holder, the holder's estate, the holder's creditors or the creditors of the holder's estate to determine whether the conflict of interest rules barring representation would come into play.

"(9) Except as provided in paragraph (1), a person represents the person's minor and unborn descendants."

Under §7723(9), a parent can represent his or her minor and unborn descendants. Thus, using the hypothetical first presented in §7723(3), in addition to being able to represent their minor and unborn children under §7723(3), Child A and Child B can represent their minor and unborn children under §7723(9).

Note, however, that if the settlor and all beneficiaries of an inter vivos noncharitable trust wish to modify or terminate the trust under §7740.1(a) (modification of a trust without court approval), the settlor may not represent his or her minor children under §7723(9) or any other paragraph in §7723. §7740.1(a).[3]

Conflicts of Interest

Conflicts of interest in the context of §7723(7) and §7723(8) were briefly discussed above. The Pennsylvania Comment to §7723 also discusses conflicts of interest with respect to other scenarios:

"The interplay between paragraphs (4) and (5) is illustrated by the following example. Suppose a trust provides that income is payable to testator's spouse and upon the spouse's death the principal is payable to the testator's children (or descendants of deceased children) and in default of descendants to the testator's heirs. If one or more children are sui juris, they represent all the testator's descendants by virtue of paragraph (4), and they represent all heirs by virtue of paragraph (5).

Consequently, the sui juris children represent other children, descendants and heirs. If the trust were to continue for the children's lives with remainders to grandchildren, the sui juris children may represent all children but would not represent the class of grandchildren with respect to some financial matters because of the conflict of interest between the life and remainder beneficiaries."

Whether there is a conflict of interest depends on the type of action to be taken. As described above, a modification to permit income beneficiaries access to principal will be a conflict of interest with the remainder beneficiaries. However, other more administrative actions may not result in a conflict of interest, such as modifying certain successor trustee provisions or waiving the filing of an accounting with the court. Whether or not there is a conflict of interest must be determined on a case-by-case basis.

§7724

§7724 provides that, in a judicial proceeding concerning a trust matter, the court may appoint a guardian ad litem for minor, unborn, unknown or unascertained beneficiaries even if they are represented under §7723 if the court determines that such beneficiaries are inadequately represented. The Pennsylvania Comment to §7724 states that §7724 preserves the power of the court to appoint a guardian ad litem in "appropriate circumstances as provided in §751(6). §751(6) permits the court to appoint a guardian ad litem if the court deems it necessary, but also permits the court to waive the appointment of a guardian ad litem if there is a sui juris beneficiary who has a "similar interest or if such person is or would be issue of a living ancestor sui juris and interested in the estate who interest is not adviser to his." §756(6).

§7725

§7725 requires that a person who will represent another person or class of persons be given written no-

continued on Page 10

[3] §7740.1(a) prohibits a settlor from virtually representing any beneficiary.

Strike While the Iron is Hot: Effective Estate Planning Techniques When Interest Rates Are Low

By DAVID A. RUBEN
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The economy has been hit hard in the last few months. Interest rates have plummeted along with world markets. While it might seem counterintuitive to transfer wealth in tough times, many lifetime giving techniques are actually most effective when interest rates are low. This article will summarize some of these techniques.

Intra-family loans

Intra-family loans are perhaps the most straightforward way to transfer wealth and take advantage of low interest rates. There will be no gift tax consequences for a loan to family members as long as the lender charges interest at least equal to the applicable federal rate (AFR). The January AFR is 0.81% for loans of up to 3 years, 2.06% for loans of 3 to 9 years and 3.57% for loans of over 9 years. Individuals can lend their children or other family members an unlimited amount of money at these very low interest rates and any return generated by the borrower in excess of the AFR is retained without gift tax. Often these loans are used by family members to buy homes, start businesses or simply invest the money where returns in excess of the AFR are expected.

GRATs

Another technique that takes advantage of low interest rates is a Grantor Retained Annuity Trust (GRAT). This is an irrevocable trust into which a grantor transfers assets and retains an annuity interest for a specified term. The amount of the taxable gift is the fair market value of the assets transferred to the trust minus the value of the grantor's retained annuity interest. Assuming the grantor uses a nearly "zeroed out" GRAT, there is nominal gift tax upon formation and at the end of the term any appreciation in excess of the section 7520 rate (the January Section 7520 rate is 2.4%) is essentially transferred to the beneficiaries without gift tax. GRATs are especially attractive when the section 7520 rate is low.

Sale to IDGTs

A technique that is similarly effective in a low interest rate environment is the sale of assets to an intentionally defective grantor trust (IDGT). Assets are sold to an IDGT in return for an installment note bearing an interest rate usually equal to the AFR. The estate tax values of the assets are frozen and any post-sale appreciation in excess of the AFR accrues to the trust without gift tax.

A trust is "defective" if it violates one of the grantor trust rules contained in Sections 671 through 679 of the Internal Revenue Code. This violation results in the grantor

continued on Page 11

PA UTA, continued

tice "by the trustee that the person is representing the other person. The person to whom the notice is given may decline the representation by a writing that is given to the trustee no later than 60 days after receipt of the trustee's notice." §7725. Note that §7725 requires that the trustee give the person notice that he or she will represent another person. What if the beneficiaries wish to modify a trust to permit removal of the trustee, and the trustee is an adverse party to the proceeding?

§7726

§7726 states that "a person may not represent another who is sui juris and files a written objection to representation with the trustee." This assumes, however, that such person knows that he or she is being represented. Although both §7710.1 (nonjudicial settlements) and §7740.1(b) (judicial modification) both require that all beneficiaries consent, there is no requirement that all beneficiaries receive notice. Does §7726 imply that all beneficiaries need to receive notice even if they are being represented by another? If not all beneficiaries, perhaps all sui juris beneficiaries? That would seem to defeat the purpose of virtual representation in the first place, especially with trusts involving dozens or even hundreds of remote contingent beneficiaries for large families and long-lived trusts.

Estate Planning Techniques, continued

of the trust being treated as the owner of the trust for income tax purposes but not, if the trust is properly structured, for estate tax purposes. This is beneficial for several reasons. As the grantor is treated as the owner of the trust for income tax purposes, the grantor will not recognize any gain on the initial sale of assets to the trust. In addition, the grantor will pay income taxes on income generated by the trust assets, allowing the assets to grow without the trust having the responsibility for the income taxes. As with GRATs, the success of this technique depends upon the assets in the trust generating a rate of return in excess of the AFR.

CLATs

For philanthropically inclined individuals a charitable lead annuity trust (CLAT) is a great way to transfer wealth when interest rates are low. In a CLAT, the donor transfers assets to a trust that provides annuity payments to a designated charity for a fixed term. At the expiration of the trust term, the remaining assets are distributed to non-charitable beneficiaries. The amount of the taxable gift is the fair market value of the assets transferred to the trust less the present value of the charitable annuity. CLATs often vary the payout rate to the charity to result in nominal gift upon formation (similar to "zeroing-out" a GRAT). CLATs are most effective when interest rates are low because any returns generated by the trust assets in excess of the section 7520 rate essentially pass free of gift tax to the non-charitable beneficiaries (assuming the CLAT is nearly "zeroed-out").

In addition, a CLAT that violates one of the grantor trust rules will receive a charitable income tax deduction upon formation. Non-grantor trust CLATs will not receive the upfront charitable deduction but all of the distributions to the charity will be tax-deductible for income tax purposes.

NEWSLETTER ARTICLES

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

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Two Items from the Worker, Retiree, and Employer Recovery Act of 2008

By ROBERT H. LOUIS
SAUL EWING LLP

Among the provisions contained in this law, passed by Congress and signed by President Bush late in 2008 are two items that are of interest to planners:

The rules of Section 401(a)(9) of the Internal Revenue Code, requiring minimum distributions when an individual has reached age 70½, are suspended for 2009, for individual retirement plans and defined contribution qualified retirement plans (including plans under Section 403 and 457(b). The relief applies as well to after-death distributions to beneficiaries.

Rollovers by nonspouse beneficiaries of retirement plan accounts will now be required in qualified plans, for plan years beginning after December 31, 2009. Previously, this provision might have been applicable only if the particular plan permitted it although there was some uncertainty about this interpretation. This change clarifies a valuable planning technique available when an individual with a qualified plan, 403 or 457 account, dies with a balance remaining and names a beneficiary other than the individual's spouse.

2009 Planning Numbers

By ROBERT H. LOUIS
SAUL EWING LLP

		2009	2008
Contribution and Benefit Limits			
§401(k), §403(b), §457(b) elective deferral limit		$16,500	$15,500
§401(k), §403(b), §457(b) catch-up deferral limit		$5,500	$5,000
Definition of highly compensated employee		$110,000	$105,000
Annual compensation limit for benefit purposes		$245,000	$230,000
Annual compensation limit for key employee determination		$160,000	$150,000
Defined benefit plan limit at age 62:	Annual amount	$195,000	$185,000
Defined contribution plan limit:	Annual amount	$49,000	$46,000
	Percent of pay	100%	100%
Individual Retirement Account Contributions			
Traditional, spousal and Roth contribution limits		$5,000	$5,000
Catch-up contribution limit		$1,000	$1,000
Employee Stock Ownership Plans			
Maximum balance for 5 year distribution		$985,000	$935,000
Amount to lengthen 5 year period		$195,000	$185,000
Qualified Transportation Benefit – Monthly limits			
Parking		$230	$220
Transit pass/Commuter vehicle		$220	$115
Health Savings Accounts			
Single:	Annual contribution limit	$3,000	$2,900
	Deductible	$1,150	$1,100
	Out-of-pocket maximum	$5,800	$5,600
Family:	Annual contribution limit	$5,950	$5,800
	Deductible	$2,300	$2,200
	Out-of-pocket maximum	$11,600	$11,200
Social Security			
OASDI tax rate		6.20%	6.20%
OASDI taxable wage base		$106,800	$102,000
Cost of living adjustment for benefits		5.80%	2.30%
Maximum annual benefit for person at full retirement age, assuming no earnings during the year		$27,876	$26,220
Retirement Earnings Test Exempt Amounts:			
Over full retirement age		No limit	No limit
Year full retirement age attained:	Annual amount	$37,680	$36,120
	Monthly amount	$3,140	$3,010
Below full retirement age:	Annual amount	$14,160	$13, 560
	Monthly amount	$1,180	$1,130

	2009	2008
Social Security Normal Retirement Age	66 years, 0 months (If born in 1944)	66 years, 0 months (If born in 1943)
Medicare		
Part A tax rate	1.45%	1.45%
Part A taxable wage base	Unlimited	Unlimited
Part A deductible	$1,068	$1,024
Part B deductible	$135	$135
Part B standard monthly premium	$96.40	$96.40
Deductible Long Term Care Insurance Premiums		
Age 40 or under	$320	$310
Age 41-50	$600	$580
Age 51-60	$1,190	$1,150
Age 61-70	$3,180	$3,080
Over Age 70	$3,980	$3,850
Education		
Threshold for expenses qualifying for Hope Scholarship Credit	$1,200	$1,200
Phaseout floor for Hope Scholarship and Lifetime Learning credits		
Joint returns	$100,000	$96,000
All other returns	$50,000	$48,000
Automobile Mileage		
Standard business use	55¢	58.5¢
Charitable use rate	14¢	14¢
Medical use rate	24¢	27¢
Moving expense rate	24¢	27¢
Estate Planning		
Annual gift tax exclusion	$13,000	$12,000
GST exemption	$3,500,000	$2,000,000
Amount used to calculate 2% portion of Sec. 6166 estate tax installments	$1,330,000	$1,280,000
Estate tax exemption	$3,500,000	$2,000,000
Gift tax exemption	$1,000,000	$1,000,000
Sec. 2032A special use real property reduction limit	$1,000,000	$960,000
Notice of gifts from foreign persons	$14,139	$13,561

Estate of Norman F. Shelley, 950 A.2d 1021 (Pa. Super. Ct. 2008)

By GINA CROSSEY
BLANK ROME LLP

Following the decedent's death, a panel from a cardboard cigarette carton bearing the inscription "FIRST AND LAST ONLY WILL OF DRAFT? . . . MONEY. DEVIDE MICHAEL COOKS SONS. . . . FARM MACH & MACHINES AND TOOLS MICHAEL COOK SR. LIVING MY AGE," and signed and dated by the decedent, was admitted to probate as the last will of the decedent. The cigarette carton was neither notarized nor attested by witnesses. Upon challenge by the decedent's intestate heirs, the Franklin County Orphans' Court granted summary judgment in their favor. The beneficiaries of the purported will subsequently appealed to the Pennsylvania Superior Court.

In reviewing the Orphans' Court decision, the Superior Court's initial inquiry was whether the cigarette carton provided for a positive disposition of the decedent's assets, as is required of a valid will. The court dismissed the beneficiaries' argument that the decedent's use of the term "will" constituted such positive disposition, opining that the only potentially dispositive term on the carton was the misspelled "devide", which, offering no evidence of what property was to be divided in what proportions and to whom, alone lacked the context and sufficient specificity to salvage the document. Absent this essential element for the creation of a valid will – a disposition of property – the cigarette carton was incapable of qualification as such.

The court's second consideration was whether the cigarette carton evidenced animus testandi, the requirement that a will be executed with testamentary intent, i.e., the decedent must have intended to create a legally enforceable instrument that would control the disposition of his estate at his death. Contrary to the beneficiaries' assertion that the decedent's use of the word "will" was indicative of his testamentary intent, the court observed that the simple act of labeling a document a "will" does not end the inquiry into the document's validity. Moreover, the court submitted that the decedent's addition of the word "draft" evidenced his intent to create a final document at another time, thereby contradicting any suggestion of testamentary intent otherwise afforded by the nomenclature "will."

Finally, in response to the beneficiaries' argument for the admission of extrinsic evidence, the court responded that such evidence, admissible only when the terms of a writing clearly constitute a testamentary disposition, was inadmissible in the present case because the cigarette carton failed to make a proper testamentary disposition, as previously discussed. Thus, the Superior Court affirmed the holding of the Orphans' Court that the cigarette carton, failing to make a positive disposition of property and lacking indicia of the decedent's testamentary intent, did not constitute a valid will.

Tax Update

By JOAN AGRAN
MCCAUSLAND, KEEN & BUCKMAN

I. TREASURY REGULATIONS

Proposed Regs Issued on Substantiation and Reporting of Charitable Contributions

In *REG-140029-07, 73 Fed. Reg. 45908 (8/7/08)*, the Service has issued proposed regulations providing guidance on substantiation and reporting requirements for charitable contributions under Code Sec. 170. The proposed regs explain the charitable contribution substantiation changes made by the American Jobs Creation Act of 2004 and the Pension Protection Act of 2006. The proposed regs, which would be effective for contributions made after the date final regs are issued, would also provide guidance on what constitutes qualified appraisals and qualified appraisers for purposes of the substantiation rules for noncash gifts.

A taxpayer cannot deduct any monetary contribution unless he maintains a bank record or written communication from the donee organization showing its name, the date and amount of the contribution. For non-cash contributions, the taxpayer must have a receipt from the donee and a written record showing the donee's name and describing the gift.

No charitable deduction is allowed for any contribution, whether cash or property, of $250 or more unless the taxpayer substantiates it by a contemporaneous written acknowledgment from the donee. Goods or services that have insubstantial value and certain annual membership benefits the charity provides to the taxpayer in exchange for the contribution are disregarded in determining the $250 threshold.

With certain defined exceptions, for noncash contributions that are (i) more than $500 but not more than $5,000, the donor must attach to its return a description of the contributed property, (ii) more than $5,000 but not more than $500,000, the donor must obtain a "qualified appraisal" and attach to its return an appraisal summary, and (iii) more than $500,000, the donor must attached a qualified appraisal to its return. The Service will disallow a deduction for property contributed if these reporting requirements aren't met unless the failure is due to reasonable cause.

A qualified appraisal is one that is (i) treated as a qualified appraisal under regs or other guidance issued by the Service, and (ii) conducted by a qualified appraiser. A qualified appraiser is an individual who (i) has earned an appraisal designation from a recognized professional organization or has otherwise met minimum education and experience requirements under the regs, (ii) regularly performs appraisals for compensation, (iii) meets any other requirements prescribed by the Service, and (iv) hasn't been prohibited from practicing before IRS at any time during the three-year period ending on date of the appraisal. In addition, for an appraisal to be qualified, the appraiser must demonstrate verifiable education and experience in valuing the type of property subject to the appraisal. If the claimed value of property based on an appraisal results in a substantial or gross valuation misstatement under Code Sec. 6662, a penalty is imposed under Code Sec. 6695A on any person who prepared the appraisal and who knew, or reasonably should have known, the appraisal would be used in connection with a return or claim for refund.

Deductions aren't generally allowed for contributions of clothing and household items that are not in good used condition or better, although a deduction may be allowed if the amount claimed for the item exceeds $500 and the taxpayer includes a qualified appraisal of the item with the return.

II. COURT DECISIONS

Estate Does Not Qualify for Reduced Rates

In *Estate of Prasana Kalahasthi, (DC Cal 7/9/2008) 102 AFTR 2d 2008–5211*, decedent's husband was killed on September 11, 2001, when he was a passenger on California-bound American Airlines Flight 11 which was hijacked and crashed into the north tower of the World Trade Center in New York. Decedent, devastated by her husband's death, committed suicide on October 19, 2001.

After the terrorist attacks, Congress passed the "Victims of Terrorism Tax Relief Act of 2001" to afford tax relief to victims of the attacks. Under the act, estates of "qualified decedents" are taxed

continued on Page 16

Tax Update, continued

at a reduced rate according to the schedule set out in Code Sec. 2201(c). A "qualified decedent" is any specified terrorist victim (as defined in Code Sec. 692(d)(4), which is defined as any decedent who dies as a result of (i) wounds or injury incurred as a result of the terrorist attacks against the U.S. on April 19, 1995, or September 11, 2001, or (ii) illness incurred as a result of an attack involving anthrax occurring on or after September 11, 2001 and before January 1, 2002.

Decedent's estate computed the estate tax due using the reduced rates of Code Sec. 2201. The Service determined that the estate wasn't eligible for the reduced rates, and assessed a deficiency of $669,553. The estate paid the deficiency, then filed a refund claim which the Service denied, and the estate sued in district court.

The estate claimed that the (CA) state court determined decedent was a victim of the terrorist attacks. The district court ruled this not to be the case, and that even had the probate court determined that decedent was a victim of the attacks, the law is clear that such a determination is not binding for purposes of assessing federal estate taxes.

Noting that (i) the resolution of the case centered around the proper interpretation of the definition of specified terrorist victim, and (ii) the reduced tax rate in Code Sec. 2201 is equivalent to a tax deduction, the court agreed with the Service that the provision must be strictly construed against the taxpayer. To qualify for the estate tax reduction, the court said that the estate had to show that decedent was a qualified decedent, which, in turn, required a showing that she was a specified terrorist victim. The estate argued that she was a decedent who died as a result of wounds or injury incurred as a result of the attacks, reasoning that she need not have been present at the site of the attacks to be considered a victim and that she died as a result of the attacks. The Service countered that the statute excludes decedent because (i) she was never wounded or injured as those terms are used in the statute, and (ii) she did not commit suicide as a result of the attacks.

The district court said that the first question was whether decedent's death was caused by wounds or injury. Although the parties agreed that her death was caused either directly or indirectly by emotional suffering arising out of the terrorist attacks, the court concluded that "wounds or injury" in Code Sec. 692(d)(4) must be physical. Therefore, decedent's emotional distress and suicide were not covered by the statute and her estate did not qualify for the reduced estate tax rates under Code Sec. 2201.

CRT Modification Too Late to Prevent Disallowance of Deduction

In *ESB Financial v. U.S., No. 07-1059-JTM (D. Kan. 9/23/08)*, decedent's revocable trust provided for the principal remaining at decedent's death to be distributed to a charitable remainder trust, the terms of which provided that all of the net income would be paid to decedent's daughter for her lifetime and following daughter's death, the remaining balance would be paid to a charitable organization.

About one year after the deadline to file decedent's estate tax return, the trustee of the charitable trust filed a court petition to modify the terms of the trust to conform with Code Sec. 2055. The court ordered the modification and the estate claimed a charitable deduction for the amount paid to the charitable trust. The Service disallowed the deduction because the reformation was not timely and the estate appealed.

On the basis of these facts, the district court held that the Service properly disallowed the charitable deduction because the trustee did not commence the judicial proceeding for modification of the trust within the time period required by Code Sec. 2055(e)(3)(C)(iii). That section of the Code requires that the commencement of the judicial proceeding for modification occurs within 90 days of the due date of the estate tax return. The court stated that it the 90-day requirement is binding and should be strictly construed, and that there was no question in this case that the effort was begun outside that period.

Tax May Not Be Reallocated After Statute of Limitations Has Run

In *Rosen Est. v. Comr., 131 T.C. No. 8 (10/20/08)*, on June 4, 2001, decedent's estate filed decedent's 2000 income tax return and paid the liability reported on that return, which included almost $500,000 of Code Sec. 1291 interest on a distribution from a passive foreign investment company. On July 7, 2001, the estate filed decedent's estate tax return and paid the liability reported on that return. On August 13, 2001, the Service mistakenly assessed only part of the liability reported on the income tax return and refunded to the estate the Code Sec. 1291 interest. The estate voided the refund check and returned the check to the Service with a letter stating that the refund was apparently made in error.

continued on Page 17

Tax Update, continued

On September 3, 2001, the Service assessed additions to the estate tax return. Later in September 2001, after receiving the voided check, the Service recorded the tax reflected in the voided check as a payment of decedent's 2000 income tax, thus showing that decedent had overpaid his 2000 income tax. In June 2002, the Service credited to decedent's unpaid assessed estate tax liability the income tax overpayment, thereby resulting in an overpayment of estate tax. In November 2005, after the three-year period of limitations had expired as to decedent's 2000 income tax, the Service recharacterized as an income tax payment the amount of the overpayment credited in June 2002 to the estate's estate tax, thus decreasing the estate's estate tax payments by a similar amount.

On the basis of these facts, the Tax Court first noted that in making the determination of the amount of the disputed estate tax overpayment it must decide whether the estate made "any payment of estate tax in excess of that which is properly due." The court concluded that the disputed funds represent a payment of decedent's estate tax and enter into the calculation of the overpayment of that tax, since the Service was not entitled in November 2005 to recharacterize the disputed funds as it did, because the three-year period of limitations for assessment as to decedent's 2000 income tax had expired before the recharacterization. The court finally noted that the estate tax return claimed a deduction for the taxes paid on decedent's final income tax return, and the parties' computations should adjust that deduction so that it does not include the amount of those taxes that were credited as a payment of estate tax.

Gross Misstatement of Value of Qualified Conservation Contribution

In *Whitehouse Hotel Ltd. P'ship v. Comr., 131 T.C. No. 10 (10/30/08)*, a Louisiana limited partnership acquired a historic building as well as an adjacent building and parking garage in New Orleans to operate as a hotel. The partnership conveyed to a nonprofit corporation a servitude in the historic building providing that the partnership must maintain and not alter the facade of the building.

Based on an appraisal, the partnership claimed a charitable contribution deduction of $7.45 million for the conveyance of the servitude. The Service reduced the deduction to $1.15 million, assessing an accuracy-related penalty under Code Sec. 6662(a), from which the partnership appealed. In the Tax Court, the partnership's expert witness valued the servitude at $10 million while the Service's expert witness determined that the servitude did not decrease the value of the property.

On the basis of these facts, the Tax Court held that the partnership overstated the deduction and that the fair market value of the servitude was $1.79 million. The court found that the valuation methods used by the partnership's expert used were less reliable than the methods applied by the Service's expert. The court made its own valuation of the property before the servitude, taking into account the evidence, and subtracting the Service's expert's valuation of the property after the servitude.

The court held further that the partnership made a gross valuation misstatement in its valuation of the servitude and that it is therefore subject to an accuracy-related penalty under Code Sec. 6662(a). The court found that what it determined to be a 415% valuation misstatement is a gross valuation misstatement because it exceeds 400%, the statutory threshold, and the partnership failed to show reasonable cause for the misstatement despite its reliance on an appraisal because the partnership failed to show that it made a good faith investigation of the value of the servitude.

III. IRS REVENUE RULINGS, REVENUE PROCEDURES AND NOTICES

Certain Dispositions of CRT Interests Identified as "Transactions of Interest"

In *Notice 2008-99, 2008-47 I.R.B. 1194*, the Service has added as a "transaction of interest" for purposes of Regs. §1.6011-4(b)(6) and Code Secs. 6111 and 6112 certain dispositions of all interests in a charitable remainder trust when the grantor (or other noncharitable recipient) receives the value of his or her interest but claims to recognize little or no gain.

One variation of the transaction is when: (i) a grantor funds a CRT with appreciated assets, retaining an annuity or unitrust interest, claiming a charitable deduction for the value attributable to the remainder interest, (ii) the grantor claims to recognize no gain when the CRT sells or liquidates the contributed assets and reinvests the net proceeds in new assets, which may be a diversified portfolio, (iii) the grantor and charity, in a claimed Code Sec. 1001(e)(3) transaction, then sell or otherwise dispose of their respective interests in the CRT to an unrelated third party for an amount that approximates the fair market value of the CRT's assets; and (iv) the CRT terminates and distributes

continued on Page 18

its assets to the third party.

Because the CRT is generally exempt from tax under Code Sec. 664, the CRT's sale of the appreciated assets is exempt from income tax and the CRT's basis in the new assets is the price the CRT paid for those assets. The grantor takes the position that (i) the CRT sold its entire interest as described in Code Sec. 1001(e)(3) and therefore Code Sec. 1001(e)(1), which disregards basis in a sale of a term interest, does not apply, and (ii) under Code Sec. 1001(a), the gain on the sale of the grantor's term interest is computed by taking into account the part of the uniform basis derived from the new assets' basis allocable to the grantor's term interest under Regs. §§1.1014-5 and 1.1015-1(b). Under Code Sec. 664, the grantor may have been taxed on a portion of the CRT's ordinary income and capital gains when the grantor received the annuity or unitrust payments.

The Service states that the transaction may vary from the facts described in the following ways: (i) a net income with make-up charitable remainder unitrust may be used in some cases, (ii) the CRT may have been in existence for some time before the sale of the CRT interests, (iii) the appreciated assets could be in the CRT before the transaction commences, (iv) the recipient and seller of the annuity or unitrust interest could be the grantor and/or another person, and (v) the grantor may contribute the appreciated assets to a passthrough entity and then contribute the interest in the entity to the CRT.

The Service's concern is the manipulation of the uniform basis rules to avoid gain from the sale or other disposition of appreciated assets. In the described transaction, the gain on the sale of the appreciated assets is never taxed even though the grantor receives his or her share of the appreciated value of those assets. The creation and funding of a CRT or a CRT's reinvestment of contributed appreciated property alone is not a transaction subject to this Notice.

Transactions that are the same as, or substantially similar to, the transaction described above are transactions of interest for purposes of Regs. §1.6011-4(b)(6) and Code Secs. 6111 and 6112 effective October 31, 2008. Persons entering into such transactions on or after November 2, 2006, must disclose the transaction as described in Regs. §1.6011-4. In addition, material advisors making a tax statement on or after November 2, 2006 (as to transactions entered into on or after that date) have Code Sec. 6111 and 6112 disclosure and list maintenance obligations. The Regs. §301.6111-3(b)(3)(i)(B) material advisor threshold amounts are reduced to $5,000. The Service stated that the charitable remainder beneficiary is not a participant if it disposed of its CRT interest on or before October 31, 2008 but, otherwise, is a participant for the first year for which the charity's tax return reflects the disposition of the charity's interest.

Lastly, the Service noted that penalties may apply under Code Secs. 6707A, 6707(a), 6708(a), 6662 and 6662A.

IV. IRS PRIVATE LETTER RULINGS AND TECHNICAL ADVICE MEMORANDA

Estate Permitted to Correct QTIP Election Due to Mathematical Error

In *PLR 200832011*, decedent died in 2005, when the amount excluded from tax by the unified credit was $1.5 million. The decedent's estate tax return was prepared in 2006, when the amount excluded from tax by the unified credit was $2 million. In preparing the estate tax return, the attorney mistakenly used $2 million as the applicable exclusion amount in computing the estate tax. Although it was intended that a QTIP election be made in the amount necessary to reduce the estate tax return to zero, in actuality the amount of the QTIP election made on the return was $500,000 less than the amount that was actually needed to reduce the estate tax to zero.

The Service notified the estate that the incorrect unified credit amount had been used, and that this error resulted in an underpayment of estate tax. The estate then filed a supplemental estate tax return which (i) corrected the amount of the unified credit, (ii) made a QTIP election for an amount that was $500,000 greater than the amount for which the original QTIP election had been made, and (iii) reported a tax liability of zero. The Service allowed a marital deduction for the full amount for which a QTIP election was made on the supplemental return.

Proposed Grant of Conservation Easement OK'd

In *PLR 200836014*, a business entity proposed to make a grant of a conservation easement in perpetuity on real property consisting of forest, marsh and saltwater habitats for endangered species to a qualified public charity in perpetuity. The charity was created to preserve natural and rural land along the coast of the state in which the forest is located.

continued on Page 19

Tax Update, continued

On the basis of these facts, the Service ruled that the proposed grant of a conservation easement will be a qualified conservation contribution because it meets the three necessary requirements: (i) the easement must be on real property that is either in a natural or relatively natural state, is agricultural land or has significant historical value, (ii) the property must be granted to an organization that is committed to the protection of natural resources for conservation purposes as defined under Code Sec. 170(h)(4), and (iii) the easement must be exclusively for conservation purposes and must last in perpetuity.

In this case, the Service concluded that (i) the easement is on relatively natural land containing endangered species, meeting the first requirement, (ii) the organization acquiring the easement is a qualified Sec. 501(c)(3) nonprofit dedicated to the preservation of natural lands, and the easement is for both the protection on an environmental system and preservation of open space, and (iii) the easement was granted in perpetuity, as evidenced by the easement document.

Interest on Deferred Estate Tax Nondeductible as Personal Interest

In *CCA 200836027*, due to economic hardship, an estate requested and was granted an extension of time for paying the estate tax under Code Sec. 6161 because the estate lacked liquid assets to pay income and estate taxes that were owed. During the period of extension for paying the estate tax, interest on the unpaid estate tax continued to accrue. The estate later sold real estate to pay the taxes. On the Form 1041 filed by the estate, a deduction was claimed for the amount of interest due on the unpaid estate tax. The estate subsequently paid the estate tax and interest due under the extension without claiming a deduction on the estate tax return for the related interest.

On the basis of these facts, the Service ruled that interest on estate tax accrued during the period of a hardship extension for paying tax under Code Sec. 6161 is nondeductible personal interest under Code Sec. 163(h)(2). Therefore, the estate couldn't deduct the interest on its income tax return. Under Code Sec. 163, only six types of interest qualify as deductible, non-personal interest. Code Sec. 163(h)(2)(E) provides that where an extension of time for payment of estate tax is in effect under Code Sec. 6163, the interest payable on the estate tax during that period of extension is allowable as an income tax deduction. Code Sec. 6163 allows an extension of time for payment of estate tax on the value of reversionary or remainder interest in property. Other than under Code Sec. 6163, unless the interest qualifies as nonpersonal interest, all interest with respect to other extensions of time for paying estate tax is considered personal interest for purposes of the income tax deduction. Since none of those exceptions applied in the present case, the estate could not deduct the interest on its income tax return.

Charitable Deduction Denied

In *TAM 200840008*, decedent's Will provided that decedent's residuary estate was to be held in trust with 50% of the net income distributed annually to two named individuals for life, and the remaining income distributed annually to qualified charities in the trustees' discretion. Upon the trust's termination, the principal would be distributed to qualified charities. Because the trust failed to meet the requirements for a charitable deduction under Code Sec. 2055(e)(2), and to decrease the potential estate tax due, the trustees proposed to divide the trust into two separate trusts under applicable state law. Each trust would be funded with one-half of the net residue of the estate. One trust would provide that all income was to be distributed to qualified charities. The second trust's income was to be distributed equally to the named individuals. On the estate tax return, the executor claimed a charitable deduction for the date-of-death value of the assets distributed to Trust No. 1.

On the basis of these facts, the National Office advised that the trust did not satisfy the requirements of Code Sec. 2055(e)(2) because (i) the trustees had not timely reformed the trust, and (ii) the trust did not qualify for the relief from the disallowance provision because the only reason given for dividing the testamentary trust was to decrease the federal estate tax liability and therefore there was no valid non-tax reason to permit relief in this circumstance.

Conservation Easement Denied For Sec. 2032A Farm

In *PLR 200840018*, father died, leaving his farm to taxpayer. On schedule A-1 of the federal estate tax return, the executor elected under Code Sec. 2032A(a) to value the real property based on its use as a farm rather than its assumed highest and best use. Following father's death, taxpayer continued to operate the property as a farm. Taxpayer proposes to sell a qualified conservation easement on the farm to a land trust, the primary purpose of which is to protect the agricultural soils, agricultural viability, and

continued on Page 20

Tax Update, continued

agricultural productive capacity of the farm in perpetuity. The land trust is a Code Sec. 501(c)(3) organization. Taxpayer requested a ruling that the qualified conservation easement exception of Code Sec. 2032A(c)(8) would apply to the transfer.

Code Sec. 2032A(c)(1) provides that if the heir disposes of any interest in the property (other than to a member of family) within 10 years after the death of the decedent or the heir ceases to use the property for its qualified use, there is imposed an additional estate tax. The tax calculation, which is essentially a recapture of the farm use valuation discount, is based on the difference between the use value of the property and the fair market value of the property as of the date of the decedent's death.

Code Sec. 2032A(c)(8) provides for an exemption from recapture for contributions made for qualified conservation easements. Taxpayer's position is that the sale to the land trust qualifies for the conservation easement exception. However, the Service stated that the exception is for the contribution of an easement and not the sale of an easement. The exemption therefore was denied and the recapture of farm use valuation savings is applicable.

Grantor's Substitution of Personal Assets for Trust Assets of Equal Value OK'd.

In *PLR 200842007*, grantor created a trust, retaining the power to substitute assets of equal value for the assets held in the trust. The trust terms require that (i) the trustee be neither related to nor subordinate to grantor, and (ii) the independent trustee has a duty to ensure that the value of the assets being acquired is equivalent to the value of the assets that are substituted by grantor.

Grantor plans to exercise this power by transferring shares of stock that Grantor currently holds in one company in exchange for shares of stock that the trust currently holds in a different company. The stock of both companies are publicly traded and grantor and the trust will value the stock for the exchange at the mean between the highest and lowest quoted selling price on the exchange on which the shares are sold on the date of transfer. If necessary, Grantor will transfer to or withdraw from trust cash or cash equivalents in an amount necessary to make the total value of the assets transferred to the trust equal to the total value of the assets withdrawn from the trust as a result of the substitution.

On the basis of these facts, the Service ruled that (i) grantor's retained power of substitution will not cause the trust property to be included in grantor's estate for estate tax purposes, (ii) the exercise by grantor of the power of substitution will not constitute a gift to the trust for gift tax purposes if the total fair market value of assets transferred to the trust equals the total fair market value of assets transferred from the trust, and (iii) the trust is a grantor trust all of which is treated as owned by the grantor under Code Sec. 671, and therefore, grantor's exercise of the power of substitution will not result in the recognition of any gain or loss by grantor or the trust for federal income tax purposes.

Extension of Time Granted to Make QDOT Election

In *PLR 200842018*, decedent, a U.S. citizen, was survived by his spouse who is a permanent resident. Decedent's residuary estate passed outright to his spouse. The accountant who prepared the estate tax return erroneously assumed that, because spouse was a lawful permanent resident, property passing to her from decedent qualified for the marital deduction under Code Sec. 2056(a). As a result, a marital deduction was claimed, but no Code Sec. 2056A(d) election was made.

Following the filing of the return, spouse created a QDOT described in Code Sec. 2056A, and irrevocably assigned to the QDOT all of the interests that passed outright to her under decedent's Will. Subsequently, the accountant filed a supplemental estate tax return, making a QDOT election and requesting an extension of time under Regs. §§301.9100-1 and 301.9100-3, to assign the property to the QDOT and to make a QDOT election.

Under Code Sec. 2056(d) and Regs. §20.2056A-3(a), the election to treat a trust as a QDOT must be made on the last estate tax return filed before the due date or, if a timely return is not filed, on the first estate tax return filed after the due date. The election, once made, is irrevocable, and no election may be made if the return is filed more than one year after the due date of the return. However, the Service explained that Regs. §301.9100-3 provides an extension will be granted when the taxpayer provides evidence it acted reasonably and in good faith, and that Regs. §301.9100-3(b)(1)(v) provides that a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional, and the tax professional failed to make, or advise the taxpayer to make, the election.

On the basis of these facts, the Service determined that

continued on Page 21

the executor had reasonably relied on a qualified tax professional for preparation of the estate tax return. Exercising its discretion under Regs. §301.9100-1(c), the Service granted the estate a 60-day extension of time to assign property to the QDOT and to make the QDOT election.

Decedent's Interest in LLC Qualifies Under Code Sec. 6166

In *PLR 200845023*, decedent was the sole member and a full-time employee of an LLC which owned cash, securities, an automobile, and interests in three real properties. Decedent, through the LLC, managed two of the properties. Although each of these two properties had resident managers that were agents of the LLC, decedent handled all aspects of day to day management, including setting rental rates and lease terms, reviewing rental applications, executing leases, collecting rent, authorizing repairs, and building and grounds maintenance.

Neither decedent nor the LLC provided any management services with respect to the third property. Decedent's estate requested an extension of payments under Code Sec. 6166 based on decedent's interest in the LLC qualifying as a closely held business interest.

On the basis of these facts, the Service ruled that the value of decedent's interest in the LLC attributable to the two properties managed by decedent qualified as an interest in a closely held business for purposes of Code Sec. 6166, and therefore, provided the other Code Sec. 6166 requirements are met, the payment of estate tax attributable to these properties may be paid in installments under Code Sec. 6166. The Service cited *Rev. Rul. 2006-34, 2006-1 C.B. 1171*, which provides a non-exclusive list of factors that are generally relevant in determining whether activities with regard to real property support a finding that the real property interest constitutes a closely held business interest under Code Sec. 6166.

The Service also ruled that the estate tax attributable to the value of the third property may not be paid in installments because it is a passive asset.

Estate Not subject to Tax on Distribution of Decedent's Pension to Charity

In *PLR 200845029*, decedent's Will named a certain charity as a residuary beneficiary of his estate. His estate was named the beneficiary of his interest in a defined benefit pension plan. The executor of decedent's estate proposes to assign the interest in the plan to the charity in partial satisfaction of the charity's share of the residue. The Will gives the executor the power to distribute property in kind; state law permits distributions in kind without any requirement that they be made on a pro-rata basis.

On the basis of these facts, the Service concluded that due to the assignment of decedent's interest in the plan to the charity in partial satisfaction of its share of the residuary estate, only the charity will include the IRD in the plan in its gross income when the distribution or distributions from the plan are received by the charity. Code Sec. 691(a)(1) provides that if the estate of a decedent or any person transmits the right to IRD to another who would be required to include such income when received in his gross income, only the transferee will include such income when received in his gross income.

Further, under Reg. § 1.691(a)-4(b), if a right to IRD is transferred by an estate to a specific or residuary legatee, only the specific or residuary legatee must include such income in gross income when received.

Children's Disclaimer of Interest in IRA Not Qualified

In *PLR 200846003*, decedent and her husband entered into a prenuptial agreement under which decedent agreed to establish a trust under her Will for the benefit of husband and to designate this trust as the beneficiary of her IRA. Decedent's Will created the trust which provides that husband is to receive all of the net income in quarter annual installments for his lifetime. Upon husband's death, the remaining assets of the trust which consists of the IRA, will be distributed to an inter vivos trust that decedent had created prior to her marriage to husband. The inter vivos trust provides that upon decedent's death, the trust estate is to be distributed in equal shares to decedent's then living children.

Decedent executed a beneficiary form designating her children as the beneficiaries of the IRA. Within nine months of Decedent's death, the children disclaimed their interests in the IRA in writing, delivered the disclaimers to the executors of Decedent's estate, and filed the disclaimers in probate court. As a result of the disclaimers, the IRA passes, by specific bequest in Decedent's Will, to the trust created for husband.

On the basis of these facts, the Service ruled that decedent's children's disclaimers are not qualified disclaimers for purposes of Code Sec. 2518 because the children did not disclaim their entire

continued on Page 22

Tax Update, continued

interest in the IRA. Because the IRA will be distributed to the inter vivos trust upon husband's death and the children did not disclaim their interests in the inter vivos trust, the children did not disclaim their entire interest in the IRA.

In addition the Service ruled that the trust for husband under decedent's Will does not qualify as a QTIP trust under Code Sec. 2056(b)(7) and therefore is not entitled to a marital deduction under that code section. To qualify as a QTIP trust the IRA must have passed from decedent. Because the Service determined that for federal gift tax purposes, the children have made a taxable gift of the fair market value of the IRA, for federal estate tax purposes the IRA passed not from the decedent but from the children.

Trust under Decedent's Will not Designated Beneficiary of IRA

In *PLR 200846028*, decedent died at age 65 in 2004 owning an IRA from which he had not commenced taking distributions. His beneficiary designation provided only "as stated in wills." Decedent's residuary estate passed under his Will to a trust which became irrevocable on his death. The trust is directed to distribute the assets to named individuals in specified percentages.

In 2005, at the request of the estate's personal representative, a state court issued an order that the phrase "as stated in wills" in the IRA beneficiary designation is a specification of the trust as beneficiary of the IRA, and more specifically that the named beneficiaries of the residual assets under the trust are the designated beneficiaries of the IRA.

The personal representative then sought a ruling that the language "as stated in wills" in the IRA beneficiary designation form be treated as a designation of the trust as the beneficiary of the IRA, and the beneficiaries of the residual assets under the trust be treated as the "designated beneficiaries" for Code Sec. 401(a)(9) purposes.

On the basis of these facts, the Service ruled that the trust named as beneficiary in decedent's Will was not the IRA's beneficiary, and the trust's beneficiaries were not the designated beneficiaries of the IRA. The Service refused to accept the court order to treat the residual beneficiaries of the trust as designated beneficiaries, because this would be inconsistent with the requirements of Code Sec. 401(a)(9) and the final regs issued under it. The beneficiaries of the IRA were not identifiable from the language on the form "as stated in wills." This language named no one and otherwise provided insufficient information to identify the IRA beneficiaries. Accordingly, decedent's estate was the beneficiary of his IRA at the time of his death and therefore he is treated as having no designated beneficiary.

Beneficiary/Trustee did not Hold General Power of Appointment

In *TAM 200847015*, decedent's husband's Will provided that the residue of husband's estate was to be held in trust, with the income and principal payable to decedent by the trustee as necessary to provide for decedent's health, support, and maintenance in the manner in which she was accustomed. Upon decedent's death, the remaining assets of the trust are to be divided into two trusts for the benefit of decedent's and husband's nephews and nieces. The trust restricted the ability of beneficiaries to assign or alienate their interests, and provided the trustee the power to discontinue payments to a beneficiary and in lieu of those payments expend funds on account of the beneficiary "in order to carry out the spirit and purpose of the provision." At the time of her death, decedent was the trustee.

On the basis of these facts, the Service advised that decedent did not possess at death a general power of appointment under Code Sec. 2041. The Service cited Code Sec. 2041(b)(1)(A) which provides that a power to consume, invade, or appropriate property for the benefit of the decedent which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent shall not be deemed a general power of appointment. Decedent's power as trustee to distribute income and principal to herself was limited to those amounts necessary to provide for her health, support, and maintenance, and thus was not a general power of appointment. The Service further found that the power to expend funds on account of a beneficiary was based on a spendthrift provision that had not been triggered at the time of decedent's death and thus was not a power that she held at death.