



Probate and Trust Law Section Newsletter

No. 132 Published by the Section on Probate and Trust Law of The Philadelphia Bar Association February 2013

Report of the Chair

By SUSAN G. COLLINGS
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During the past year the Trusts and Estate field stood on the edge of the fiscal cliff created by the lack of agreement on fiscal policy in Washington. For many estate planners, the uncertainty of what lay on the other side of the chasm resulted in a sustained and unprecedented demand from clients for gift planning before the end of 2012. The volume of work resulting from this broad-based demand was exciting, but it also presented challenges. More than ever, I was reminded about how many diverse areas of the law we, as estate planners, must navigate and master in order to meet the needs of our clients properly. Constructing a plan that is even moderately complex may require a good grasp of multiple bodies of law, including but certainly not limited to state and federal income tax for individuals, fiduciaries, partnerships and other entities, state and federal gift, estate and inheritance taxes, realty transfer tax, state property and fiduciary law, and the laws governing the formation and administration of business entities.

How do you meet your professional obligation to obtain core competency and remain current on new developments in these many varied areas? There are many excellent learning resources available through internet list serves, seminars, journals, and books, and they can be valuable in addressing many of the issues with which we must grapple. However, many of these resources operate on a national level, and cannot address the issues and opportunities that may arise from the interplay between state and federal rules. For example, under Revenue Ruling 2004-64, the question whether a discretionary power to reimburse the settlor of a grantor trust for income tax paid by the grantor will result in estate inclusion for federal estate tax purposes rests on whether such reimbursement power will expose the trust to the settlor's creditors under applicable state law. With enactment of PEF Code section 7745 in 2010, the answer to this issue for Pennsylvania trusts became clear--a grantor trust governed by Pennsylvania law will not be subject to the claims of a settlor's creditors merely because the trustee is vested with a discretionary power to
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Proposed Regulations Expand Program-Related Investment Opportunities for Private Foundations

The proposed regulations are welcome news for private foundations as they clarify that program-related investments may be made to accomplish a variety of charitable purposes through a wide range of investment vehicles.

By RICHARD L. FOX, ESQ., PARTNER
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Program-related investments (“PRIs”) have become an increasingly popular tool to advance the philanthropy of private foundations. Indeed, the Bill and Melinda Gates Foundation recently created a \$400 million fund dedicated exclusively to making PRIs.¹

¹ See “The Gates Foundation Reveals How It Makes Program-Related In-

vestments,” *The Chronicle of Philanthropy* (April 5, 2011).

vestments,” *The Chronicle of Philanthropy* (April 5, 2011).

vestments.” *The Chronicle of Philanthropy* (April 5, 2011).
improve public welfare.² Although private foundations have traditionally focused principally on grant-making activities, PRIs allow foundations to use their resources to further their charitable mission through investment activities, including by making investments with for-profit business enterprises and individuals.³

² See Evans, Petrovits and Walberg, “L3C: Will New Business Entity Attract Foundation Investments?” *The Exempt Organization Tax Review* (May 2009). The state legislation creating an L3C directly parallels the requirements for a PRI under Section 4944(c), so that the entity is legally organized with the intent to constitute a PRI. The L3C has its detractors, however, and is it questionable whether the L3C legislation actually achieves its intended purpose. See, e.g., Chernoff, “L3Cs: Less Than Meets The Eye” (*Taxation of Exempts*, May/June 2010) (“Low-profit limited liability companies have received a lot of attention lately—probably more than they deserve.”)

³ Thus, the recipient of a PRI need not be a tax-exempt organization or a member of a charitable class, as long as the recipient of the investment serves as a vehicle through which a private foundation can further its

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reimburse the settlor for income tax. However, before enactment of this PEF Code provision, the answer to this question was not readily accessible and required careful review of the applicable Pennsylvania case law. Similarly, certain issues arising in connection with qualified disclaimers under section 2518 of the Internal Revenue Code may depend on property rights governed by state law. These are just a few examples of the many instances when federal and state law intersect in our practices. They are also, I am proud to say, issues that we have addressed right here in past Section Newsletters.

This brings me to my primary point. The Probate and Trust Law Section of the Philadelphia Bar Association serves many valuable functions. As a professional organization, it provides the opportunity to forge

collegial working relationships with your colleagues at other firms and with the courts. Importantly, it also provides numerous educational forums—through its Newsletter, the Quarterly Luncheons, and presentations and dialogues that occur at committee meetings. Through all of these forums, the Section strives to provide timely and in-depth information on a broad range of topics relevant to our members in their day-to-day work—often in a way that cannot be duplicated by seminars and publications directed at a national audience.

As has been stated many times before in this column, the Section’s Newsletter, committees and educational programs depend on the input and commitment from Section members. I urge you to become an active participant, share your knowledge and experience with your colleagues, and help the Section continue to provide these valuable services.

PRI Opportunities, continued

The IRS had become aware that many private foundations were hesitant to make potential program-related investments because the existing regulations that were issued in 1972, which focus on domestic situations principally involving economically disadvantaged individuals and deteriorated urban areas did not provide the necessary degree of comfort to private foundations to ensure that the investments would constitute PRIs. The IRS also determined that the private foundation community sought regulations that would include examples reflecting modern-day investment practices and illustrating certain principles clarifying the nature of permissible PRIs.⁴

In response to the call from the private foundation community, the Treasury and the IRS have now issued proposed regulations providing new guidance in the form of nine additional examples describing permissible PRIs.⁵

own tax-exempt purposes. In Rev. Rul. 74-587, 1974-2 C.B. 162, the IRS specifically recognized that for-profit entities may serve as “the instruments by which the charitable purposes are sought to be accomplished.” Indeed, provided the expenditure responsibility requirements under Section 4945 are followed, it is permissible for a private foundation to make an outright grant to a for-profit entity as long as it is to be used exclusively for tax-exempt purposes. See Reg. 4945-6(c) (“Grants to ‘noncharitable’ organizations”).

⁴ Preamble to REG-144267-11, April 19, 2012.

⁵ REG-144267-11, April 19, 2012. The proposed regulations are the result of efforts by the Exempt Organizations Committee of the ABA Section of

The issuance of these regulations, which update the existing regulations issued 40 years ago, is welcome news for private foundations, as the examples in the proposed regulations clarify that PRIs may be used to accomplish a wider variety of charitable purposes through a wider range of investment vehicles than those described under the existing regulations.⁶ The examples contained in the proposed regulations are very detailed and instructive and reflect the types of investments that the IRS has previously determined qualify as PRIs in private letter rulings issued to specific foundations. However, having these examples in the form of regulations, as opposed non-precedential private rulings, provides more comfort to private foundations that these types of investments are viewed by the IRS as permissible PRIs. The proposed regulations do not alter the existing regulations or the general rules applicable to PRIs,

Taxation, which submitted comments to the IRS suggesting various additional examples of PRIs in 2002 and again in 2010. Following the issuance of the proposed regulations, on August 8, 2012, the Exempt Organizations Committee submitted additional comments on the examples contained in the proposed regulations.

⁶ The proposed regulations were lauded in a June 3, 2012 op-ed piece in the Wall Street Journal, Robert C. Pozen, “Why Not Venture-Capital Philanthropy?” In response to the proposed regulations, the op-ed piece states that the “U.S. Treasury wants to greenlight investments in commercial start-ups” and that “foundations now have significant new ways to advance their purposes and serve the public through investments in innovative, for-profit enterprise. In this manner, they will increase the likelihood of making scientific breakthroughs, help create more jobs, and bolster small businesses with good ideas that cannot easily get private funding.”

but demonstrate that a wide range of investments may qualify as PRIs and send a clear signal that PRIs can serve as a valid and important tool in furthering the charitable purposes of a private foundation.⁷ As a result, the proposed regulations should serve to broaden the interest of private foundations in making PRIs and may offer potential recipients an increased opportunity to seek investments from private foundations. Although they will not become effective until they are published as final regulations, private foundations may immediately rely upon the proposed regulations before they are finalized.⁸

BACKGROUND ON PRIS

Exception to Jeopardy Investment Rules

As part of the Tax Reform Act of 1969, Congress enacted the jeopardy investment excise tax provisions under IRC § 4944 in order to deter private foundations from engaging in speculative investment practices that could jeopardize the carrying out of a private foundation’s tax-exempt purposes. Under these rules, a private foundation is prohibited from making investments that jeopardize its ability to accomplish its exempt purposes. To enforce this prohibition, IRC Section 4944 subjects private foundations and, under certain conditions, foundation managers to a two-tier tax regime for investing any amount in such a manner as to jeopardize the carrying out of any

⁷ While the proposed regulations apply only to private foundations, public charities that make loans and equity investments can also look to these regulations for guidance in determining whether an investment serves a charitable purpose.

⁸ Prop Reg. 53.4944-3(c).

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PRI Opportunities, continued

of the foundation's exempt purposes.⁹

Generally, the jeopardy investment prohibition is violated if it is determined that the foundation managers, in making an investment, failed to exercise ordinary business care and prudence, under the facts and circumstances prevailing at the time of making the investment, in providing for the long and short-term financial needs of the foundation to carry out its exempt purposes.¹⁰ Under an important exception, PRIs are not subject to the jeopardy investment excise tax rules otherwise applicable to investments made by private foundations as, pursuant to Section 4944(c), PRIs "shall not be considered as investments which jeopardize the carrying out of exempt purposes."¹¹ Therefore, as long as an investment constitutes a PRI, there is no exposure to the jeopardy investment excise tax rules notwithstanding that the investment may otherwise be considered imprudent purely from an investment standpoint.

Definition of PRI

PRIs are mission-driven investments that closely resemble grants because their primary purpose must be to further tax-exempt purposes. The idea behind a PRI is that the investment

would not have been made but for the fact that it will further the foundation's charitable mission. Specifically, a PRI is defined as an investment:

- whose primary purpose is to accomplish one or more of the purposes described in Section 170(c)(2)(B), which includes for religious, charitable, scientific, literary, and educational purposes;
- no significant purpose of which is the production of income or the appreciation of property; and
- no purpose of which is to attempt to influence legislation or participate in or intervene in any political campaign.

An investment is made primarily to accomplish tax-exempt purposes if it significantly furthers the accomplishment of the private foundation's exempt activities and would not have been made but for the relationship between the investment and the accomplishment of those exempt activities.¹² In determining whether a significant purpose of an investment is the production of income or the appreciation of property, a relevant question is whether investors who are engaged in the investment solely for the production of income would be likely to make the investment on the same terms as the private foundation.¹³ However, the fact that an investment subsequently produces significant income or capital appreciation is not, in the absence of other factors, conclusive evidence that income or appreciation was a significant purpose of the investment, and therefore does not preclude the investment from being a valid PRI.¹⁴

¹² Reg. 53.4944-3(a)(2)(i).

¹³ Reg. 53.4944-3(a)(2)(iii).

¹⁴ Reg. 53.4944-3(a)(2)(iii). For a further discussion of program-related investments, see Joseph and Kosaras,

PRIs can play an important role in a private foundation's philanthropy as, in addition to not being subject to the jeopardy investment excise tax rules,¹⁵ they are: (1) treated as qualifying distributions under Section 4942 for purposes of meeting a private foundation's five percent annual minimum distribution requirement;¹⁶ (2) excluded from the assets taken into account in calculating the five percent annual minimum distribution requirement under Section 4942;¹⁷ (3) not treated as excess business holdings under Section 4943;¹⁸ and (4) not treated as taxable expenditures under Section 4945,¹⁹ as long as the private foundation exercises expenditure responsibility when it is required to do so.

Expenditure Responsibility Requirements

If a private foundation makes a PRI with an organization other than a Section 501(c)(3) organization that is classified as a public charity,²⁰ the

"New Strategies for Leveraging Foundation Assets" Taxation of Exempts (July/August 2008).

¹⁵ Note that investment income derived from program-related investments is subject to the net investment excise tax imposed under Section 4940.

¹⁶ Reg. 53.4942(a)-3(a)(2)(i).

¹⁷ Reg. 53.4942(a)-2(c)(3)(ii)(d).

¹⁸ Reg. 53.4943-10(b).

¹⁹ Reg. 53.4945-6(c)(1).

²⁰ A public charity is a Section 501(c)(3) tax-exempt organization that is classified as a public charity under Section 509(a), with the exception of certain supporting organizations de-

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PRI Opportunities, continued

foundation must exercise expenditure responsibility pursuant to Section 4945.²¹ This is no simple task and a private foundation must understand that in making PRIs, it must take on this burden. And, if it fails to properly exercise expenditure responsibility over the PRI, the PRI will be considered to constitute a taxable expenditure, subjecting the foundation to substantial excise tax under Section 4945. The expenditure responsibility rules that apply to grants also generally apply to PRIs, although certain rules are tailored specifically for PRIs. Generally, the expenditure responsibility rules require that a foundation conduct a pre-grant due diligence of the grantee, enter into a written agreement that specifies the purposes of the investment, obtain full and complete periodic reports from the recipient indicating how the funds were spent and make full and detailed reports to the IRS on Form 990-PF regarding the use of the funds.²² In the case of a PRI, the expenditure responsibility rules specifically require that the written agreement between the foundation and the PRI recipient specify the purpose of the investment and include a commitment by the recipient: (1) to use all the funds received from the private foundation only for the purposes of the investment and to repay any portion not used for such purposes, provided that, with respect to equity investments, such repayment shall be made only to the extent permitted by applicable law concerning distributions to holders of equity interests; (2) at least once a year

scribed under Section 509(a)(3). See Section 4945(d)(4)(A)(ii).

²¹Expenditure responsibility applies to “grants” made by private foundations, which is broadly defined to include PRIs. Reg. 53.4945-4(a)(2).

²² Regs. 53.4945-5(b)-(e).

during the existence of the program-related investment, to submit full and complete financial reports of the type ordinarily required by commercial investors under similar circumstances and a statement that it has complied with the terms of the investment; and (3) to maintain books and records adequate to provide information ordinarily required by commercial investors under similar circumstances and to make such books and records available to the private foundation at reasonable times.²³

Many private foundations make grants that are subject to the expenditure responsibility rules, or otherwise generally follow the expenditure responsibility rules as part of their internal grant-making procedures. For these foundations, the exercise of expenditure responsibility over PRIs should not be overly burdensome. Other private foundations, however, and particularly smaller foundations that restrict their activities to making grants to public charities, may not be inclined to take on the expenditure responsibility requirements and, therefore, may consider engaging in PRIs overly burdensome.

RECOGNITION BY IRS OF NEED FOR ADDITIONAL GUIDANCE FOR PRIS

The IRS became aware that private foundations were hesitant to make PRIs because the examples in the existing regulations that were originally issued back in 1972 often did not make them comfortable that a proposed investment would constitute a permissible PRI. These regulations are limited to containing examples focusing only on domestic situations principally involving economically disadvantaged individuals and deteriorated urban areas and the investments in the examples are generally in the form of interest-free or below-market rate loans.²⁴ The IRS

²³ Reg. 53.4945-5(b)(4).

²⁴ Reg. 53.4944-3(b).

further found that the private foundation community would find it helpful if the regulations “could include additional PRI examples that reflect current investment practices and illustrate certain principles,” including confirming that:²⁵

- an activity conducted in a foreign country furthers a charitable purpose if the same activity would further a charitable purpose if conducted in the United States;
- the charitable purposes served by a PRI is not limited to situations involving economically disadvantaged individuals and deteriorated urban areas;
- the PRI recipients need not be within a charitable class if they are the instruments for furthering a charitable purpose;
- a potentially high rate of return does not automatically prevent an investment from qualifying as a PRI;
- PRIs can be achieved through a variety of investments, including loans to individuals, tax-exempt organizations and for-profit organizations, and equity investments in for-profit organizations;
- a credit enhancement arrangement may qualify as a PRI; and
- a private foundation’s acceptance of an equity position in conjunction with

²⁵ Preamble to REG-144267-11, April 19, 2012.

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PRI Opportunities, continued

making a loan doesn't necessarily prevent the investment from qualifying as a PRI.

The Treasury and the IRS clearly took the request by the private foundation community to heart, as the examples contained in the proposed regulations adopt the foregoing principles for purposes of determining whether an investment by a private foundation constitutes a PRI.

EXPLANATION OF PROPOSED REGULATIONS

The proposed regulations do not modify the existing regulations but, instead, provide nine detailed and instructive additional examples that illustrate that PRIs may be used to accomplish a wider variety of charitable purposes through a wider range of investment vehicles than those reflected under the existing regulations. The new examples clarify that a PRI may accomplish a wide variety of tax-exempt purposes, such as advancing science,²⁶ providing relief to the poor and distressed,²⁷ combating environmental deterioration,²⁸ and promoting the arts.²⁹ Several examples demonstrate that an investment that funds activities in one or more foreign countries,³⁰ including overseas investments that alleviate the impact of a natural disaster³¹ or that fund educa-

²⁶ Prop Reg. 53.4944-3(b), Ex. (11).

²⁷ Prop Reg. 53.4944-3(b), Ex. (14).

²⁸ Prop Reg. 53.4944-3(b), Ex. (11).

²⁹ Prop Reg. 53.4944-3(b), Ex. (17).

³⁰ Prop Reg. 53.4944-3(b), Ex. (11) and Ex. (12).

tional programs for poor individuals,³² may further the accomplishment of charitable purposes and qualify as a PRI. Thus, unlike the existing regulations, the examples in the proposed regulations make it clear that investments outside the United States may qualify as PRIs. One example illustrates that the existence of a high potential rate of return on an investment does not, by itself, prevent the investment from qualifying as a PRI.³³ Another example illustrates that a private foundation's acceptance of an equity position in conjunction with making a loan does not necessarily prevent the investment from qualifying as a PRI³⁴ and two examples illustrate that a private foundation's provision of credit enhancement can qualify as a PRI.³⁵ The final example demonstrates that a guarantee arrangement may qualify as a PRI.³⁶

The following sets forth the fact patterns in the nine new examples in the proposed regulations where the IRS concludes, in each case, that the investment constitutes a PRI:

Example 1. X is a for-profit business that researches and develops new drugs. X's research demonstrates that a vaccine can be developed within ten years to prevent a disease that predominantly affects poor individuals in developing countries. However, neither X nor other commercial enterprises like X will devote their resources to develop the vaccine because the potential return on investment is significantly less than

³¹ Prop Reg. 53.4944-3(b), Ex. (15).

³² Prop Reg. 53.4944-3(b), Ex. (16).

³³ Prop Reg. 53.4944-3(b), Ex. (12).

³⁴ Prop Reg. 53.4944-3(b), Ex. (13).

³⁵ Prop Reg. 53.4944-3(b), Ex. (8) and Ex. (9).

³⁶ Prop Reg. 53.4944-3(b), Ex. (9).

required by X or other commercial enterprises to undertake a project to develop new drugs. Y, a private foundation, enters into an investment agreement with X in order to induce X to develop the vaccine. Pursuant to the investment agreement, Y purchases shares of the common stock of S, a subsidiary corporation that X establishes to research and develop the vaccine. The agreement requires S to distribute the vaccine to poor individuals in developing countries at a price that is affordable to the affected population. The agreement also requires S to publish the research results, disclosing substantially all information about the results that would be useful to the interested public.³⁷

Example 2. Q, a developing country, produces a substantial amount of recyclable solid waste materials that are currently disposed of in landfills and by incineration, contributing significantly to environmental deterioration in Q. X is a new for-profit business located in Q. X's only activity will be collecting recyclable solid waste materials in Q and delivering those materials to recycling centers that are inaccessible to a majority of the population. If successful, the recycling collection business would prevent pollution in Q caused by the usual disposition of solid waste materials. X has obtained funding from only a few commercial investors who are concerned about the environmental impact of solid waste disposal. Although X made substantial efforts to procure additional funding, X has not been able to obtain sufficient funding because the expected rate of return is significantly less than the acceptable rate of return on an investment of this type. Because X has been unable to attract additional investors on the same terms as the initial investors, Y, a private

³⁷ Prop Reg. 53.4944-3(b), Ex. (11).

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PRI Opportunities, continued

foundation, enters into an investment agreement with X to purchase shares of X's common stock on the same terms as X's initial investors. Although there is a high risk associated with the investment in X, there is also the potential for a high rate of return if X is successful in the recycling business in Q.³⁸

Example 3. Assume the facts as stated in Example 2, except that X offers Y shares of X's common stock in order to induce Y to make a below-market rate loan to X. X previously made the same offer to a number of commercial investors. These investors were unwilling to provide loans to X on such terms because the expected return on the combined package of stock and debt was below the expected market return for such an investment based on the level of risk involved, and they were also unwilling to provide loans on other terms X considers economically feasible. Y accepts the stock and makes the loan on the same terms that X offered to the commercial investors.³⁹

Example 4. X is a for-profit business located in V, a rural area in State Z. X employs a large number of poor individuals in V. A natural disaster occurs in V, causing significant damage to the area. The business operations of X are harmed because of damage to X's equipment and buildings. X has insufficient funds to continue its business operations and conventional sources of funds are unwilling or unable to provide loans to X on terms it considers economically feasible. In order to enable X to continue its business operations, Y, a private founda-

³⁸ Prop Reg. 53.4944-3(b), Ex. (12).

³⁹ Prop Reg. 53.4944-3(b), Ex. (13).

tion, makes a loan to X bearing interest below the market rate for commercial loans of comparable risk.⁴⁰

Example 5. A natural disaster occurs in W, a developing country, causing significant damage to W's infrastructure. Y, a private foundation, makes loans bearing a below-market interest rate to H and K, poor individuals who live in W, to enable each of them to start a small business. H will open a roadside fruit stand. K will start a weaving business. Conventional sources of funds were unwilling or unable to provide loans to H or K on terms they consider economically feasible.⁴¹

Example 6. X, a limited liability company, purchases coffee from poor farmers residing in a developing country, either directly or through farmer-owned cooperatives. To fund the provision of efficient water management, crop cultivation, pest management, and farm management training to the poor farmers by X, Y, a private foundation, makes a below-market interest rate loan to X. The loan agreement requires X to use the proceeds from the loan to provide the training to the poor farmers. X would not provide such training to the poor farmers absent the loan.⁴²

Example 7. X is a social welfare organization that is recognized as an organization described in Section 501(c)(4). X was formed to develop and encourage interest in painting, sculpture and other art forms by, among other things, conducting weekly community art exhibits. X needs to purchase a large exhibition space to accommodate the demand for exhibition space within the community. Conventional sources of funds are unwilling or unable to provide funds to X on terms it considers eco-

⁴⁰ Prop Reg. 53.4944-3(b), Ex. (14).

⁴¹ Prop Reg. 53.4944-3(b), Ex. (15).

⁴² Prop Reg. 53.4944-3(b), Ex. (16).

nomically feasible. Y, a private foundation, makes a below-market interest rate loan to X to fund the purchase of the new space.⁴³

Example 8. X is a non-profit corporation that provides child care services in a low-income neighborhood, enabling many residents of the neighborhood to be gainfully employed. X is recognized as an organization described in Section 501(c)(3). X's current child care facility has reached capacity and has a long waiting list. X has determined that the demand for its services warrants the construction of a new child care facility in the same neighborhood. X is unable to obtain a loan from conventional sources of funds including B, a commercial bank, because X lacks sufficient credit to support the financing of a new facility. Pursuant to a deposit agreement, Y, a private foundation, deposits funds in B, and B lends an identical amount to X to construct the new child care facility. The deposit agreement requires Y to keep the funds on deposit with B during the term of X's loan and provides that if X defaults on the loan, B may deduct the amount of the default from the deposit. To facilitate B's access to the funds in the event of default, the agreement requires that the funds be invested in instruments that allow B to access them readily. The deposit agreement also provides that Y will earn interest on the deposit at a rate substantially less than Y could otherwise earn on this sum of money if Y invested it elsewhere. The loan agreement between B and X requires X to use the proceeds from the loan to construct the new child care facility.⁴⁴

Example 9. Assume the same facts as stated in Example 8, except

⁴³ Prop Reg. 53.4944-3(b), Ex. (17).

⁴⁴ Prop Reg. 53.4944-3(b), Ex. (18).

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MEDIATING ESTATE DISPUTES

By STEPHEN P. LAGOY

As any experienced probate law practitioner knows, estate disputes can be exceedingly complex. This is so not only because of the technical issues that arise (e.g. document interpretation, competency, domicile, tax implications, fiduciary duties, etc.), but also because of the significant emotional element that accompanies many of these disputes. The implication for the mediator functioning in this context is that, perhaps to a greater extent than in any other type of dispute, he or she must look beyond the legal positions of the parties in order to identify and understand their interests. To state it another way, the mediator in an estate dispute must go below the formal, superficial aspects

of the dispute to identify the real issues that separate the parties.

A couple examples from mediations that I recently conducted are illustrative. In one case, the dispute was ostensibly over the domicile of the decedent at the time of his death. Much effort and considerable expense was spent by the parties in trying to establish their respective positions. However, during the mediation it became apparent domicile was not really the issue. The real dispute was between the decedent's adult children and the executor named in the will. In a nutshell, the children were upset that Dad apparently did not have enough faith in them to name them as

his personal representatives. Rather, he named a friend and business associate. The children were hurt and reacted in anger, which was directed at the executor. The children's position as to domicile was motivated by the fact that the state in which they contended their Dad was domiciled would not permit the named executor, a non-resident, to serve. The resolution of the dispute required the parties to get beyond the domicile issue and focus on the interest which they had in common, namely the preservation of estate through tax avoidance strategies.

In another case, the dispute was between the executor, the decedent's brother, and a beneficiary, the decedent's unmarried partner at the time of his death. The parties were highly-charged emotionally and virtually every aspect of the estate's administration was disputed. The breakthrough moment came in a private session (sometimes called a caucus) with the executor and his counsel. In a very emotional exchange, the executor explained, apparently for the first time, that his brother's ashes had been buried on the grounds of property that he owned with his partner as joint tenants with right of survivorship. The executor did not have access to the property, could not visit his brother's grave, and was deeply troubled by that. The parties were brought together in joint session and the issue was discussed openly and resolved with the executor being granted access to his brother's grave. What followed was the amicable resolution of issues which theretofore had been insoluble.

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PRI Opportunities, continued

that instead of making a deposit of funds into B, Y enters into a guarantee agreement with B. The guarantee agreement provides that if X defaults on the loan, Y will repay the balance due on the loan to B. B was unwilling to make the loan to X in the absence of Y's guarantee. X must use the proceeds from the loan to construct the new child care facility. At the same time, X and Y enter into a reimbursement agreement whereby X agrees to reimburse Y for any and all amounts paid to B under the guarantee agreement. The signed guarantee and reimbursement agreements together constitute a "guarantee and reimbursement arrangement."⁴⁵

Conclusion

The issuance of the proposed regulations is welcome news, as they

⁴⁵ Prop Reg. 53.4944-3(b), Ex. (19).

go a long way towards adding clarity to the types of PRIs that may be made by private foundations. The nine new examples contained in the proposed regulations demonstrate that PRIs may be used to accomplish a wider variety of charitable purposes through a wider range of investment vehicles than those reflected under the existing regulations that were issued 40 years ago. The regulations also send a clear signal by the IRS that PRIs can serve as a valid and important tool in furthering their charitable purposes. As a result, the proposed regulations may serve to broaden the interest of private foundations in making PRIs and may offer potential recipients an increased opportunity to seek investments from private foundations. Although they will not become effective until they are published as final regulations, private foundations may immediately rely upon the proposed regulations before they are finalized.

When the Time is Right, Downsizing a Lifetime of Acquisitions

By AMY PARENTI

As the baby boomer generation ages, individuals, their families, and the legal professionals they may turn to face new challenges. Aging may bring health concerns or income restrictions and thoughtful planning is required to address these issues. Older individuals may need to move from a larger residence of many years to a smaller apartment, prepare their estate, and later, empty their home. Often, it's not just the individual considering the options; their children may

Mediating Estate Disputes, continued

The lesson to be taken from these examples is that, to a large extent, the mediation process in estate disputes involves the identification of the real interests of the parties, irrespective of the legal framework of the dispute. The subsurface issues, which are often highly emotional (e.g., sibling disputes, children's resentment of second spouses, and dysfunctional parent-child relationships), are the keys to dispute resolution. In such disputes, the mediator must be patient, facilitative, and perceptive in drawing out the real interests of the parties. Until these interests are recognized and dealt with, it is unlikely that the dispute will be resolved.

ED NOTE: Stephen Lagoy is a West Chester lawyer and mediator. He serves as Co-chair of the ADR Section of the Chester County Bar Association and is a member of the Orphans' Court Mediator Panel in Chester County.

help their parents make these lifestyle decisions as well.

At first glance, moving or disposing years of accumulated memories, family treasures, antiques, furniture, collections, and just "stuff" appears daunting and overwhelming. Legal professionals assisting a client may wrestle with recognizing what is of value amongst all the possessions, and a family or client may have questions such as: "What is valuable?" "Should we have a garage sale?" or "Is there a financial gain to a charitable donation?" When looking for advice on getting the most return in dollars for a client/family, a professional appraiser can offer answers to these questions and guidance.

Personal property appraisers can be found as independent practitioners, in group practices, or at auction houses. Appraisal departments from auction houses often have specialists on staff who are excellent resources for identifying and valuing a variety of property. Moreover, auction house appraisers are regularly exposed to the current market by the cyclical auction schedule, making this type of professional appraiser an ideal choice.

Before an appraiser is engaged, specific information should be obtained such as years of experience, specialization, formal training, fees, expected date of appraisal completion, and the number of appraisal document copies needed. It is also recommended to inquire if the appraiser has completed the Uniform Standards of Professional Appraisal Practice (USPAP)

course.

In response to the savings and loan crisis of the early 1980s, USPAP standards were put forth by the Appraisal Foundation to establish ethical practice standards in appraisal preparation. The IRS recognizes USPAP standards for appraisals submitted to them such as estate and charitable gift appraisals. Engaging an appraiser who is USPAP certified provides the client with a level of confidence and assurance in the completed appraisal.

Depending on the family needs, a formal appraisal that includes Fair Market Value (FMV) of the household contents may be completed or an informal walk-through may be done providing verbal estimates and indication of an item's salability. One advantage to an appraisal document is that it provides the client with an objective third party opinion of value and establishes unbiased guidelines for equitable distribution among family members. Either process will reveal current market trends, indicate property for possible sale and in what market, answer questions of what is suitable for donation, and what should just be "trashed." For example, recently an appraiser was contacted regarding a painted blanket chest that had previously been stored in a barn. After examination and research, it was determined to be a rare painted blanket chest by Johannes Spittler (1774-1837) and sold at auction for \$350,500. In another case, a Martha Watlers painting was identified

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Downsizing, continued

fied in an estate and sold at auction for \$70,000. One particular client's mother had many rings and the daughter was unaware of their value. After the appraisal was completed, she learned the value was \$50,000. Unfortunately, not every appraisal garners success stories. The market for upright pianos and mid-late 20th century cut glass is poor.

Once value has been assigned, the next step is disposal. Family members may take meaningful personal items and property may also be sold either through auction or private sales. Lastly, any remaining items may be donated or trashed. The appraiser will have resources to offer the client for sale, disposal, or "clean sweep services."

For legal professionals with clients, or the children of clients, facing the issues of aging or the complexities of dispersing an estate's personal property, engaging a USPAP certified appraiser may be the solution for all the issues at hand. A professional appraiser will be able to address the question of value, find the best market for items, and provide the due diligence clients and their family members deserve and expect.

ED. NOTE: Amy Parenti is a USPAP certified appraiser and is head of the appraisal department for Trusts & Estates at Freeman's, America's oldest auction house, in Philadelphia, PA.

With a passion for art and a special interest in American silver, modern furniture and decorative arts, she previously worked as a specialist in the American Furniture & Decorative Arts department. Amy currently acts as Freeman's regional representative for the Bucks County area.

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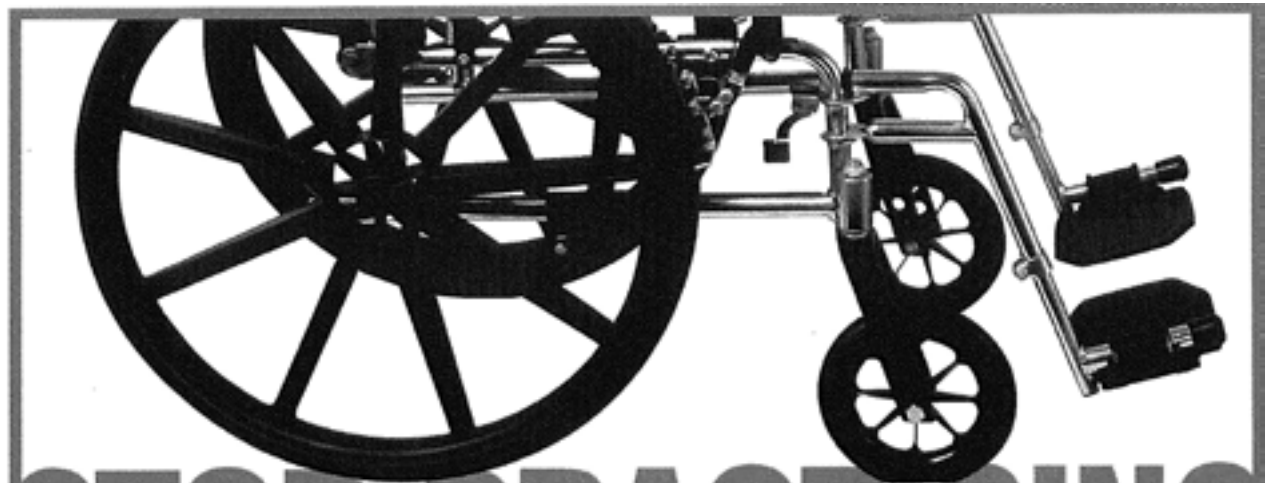
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Case Summaries from the Orphans' Court Litigation Committee

Ehrhardt Will, 2 Fid. Rep. 3d 412 (O.C. Monroe 2011)
Bortz Estate, 2 Fid. Rep. 3d 342 (O.C. Div. Westmoreland 2012)

©By TIMOTHY J. HOLMAN, ESQUIRE
SMITH KANE, LLC

Ehrhardt Will, 2 Fid. Rep. 3d 412 (O.C. Monroe 2011)

In *Ehrhardt Will*, a 2011 opinion by the Orphans' Court of Monroe County which just hit the Fiduciary Reporter, the Decedent's only child filed a petition for citation sur appeal from the Decree of the Register admitting to probate the Decedent's alleged last will and testament dated August 31, 2009 (six days before Decedent died). Petitioner alleged that Decedent suffered from a greatly deteriorated physical and mental condition, lacked testamentary capacity, and that the purported will resulted from fraud, undue influence, duress, and constraint due to the actions of Decedent's daughter/named executrix who, surprise surprise, was also the primary beneficiary of the estate.

Although those who engage in fiduciary litigation know that proving lack of testamentary capacity is incredibly difficult, particularly in a case involving a lawyer-drawn will, the Court held that the Decedent, who underwent a retroperitoneal biopsy and received 100 micrograms of Fentanyl almost immediately before

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she met with the attorney who drafted her will (a will which was dictated to the attorney by and benefited primarily the Decedent's sister), in fact lacked testamentary capacity. The Court noted that Fentanyl is a strong sedative that "remains in a patient's system for at least two hours," and that a medical provider noted that Decedent was "drowsy but arousable" when counsel arrived. The Court also noted that Decedent's medical records indicated that Decedent suffered from multiple organ failures and hypoxia, and concluded based upon medical expert testimony presented that Decedent's mental state at the time her will was executed must have been greatly compromised.

The Court paid close attention to the interactions between Decedent and the scrivener during the execution of the purported will, and noted,

[d]uring the short time [the attorney] discussed decedent's will in the hospital room, decedent mostly nodded her head or softly voiced her affirmation to his questions. Decedent never once asked an independent question of [the attorney] regarding the natural objects of her bounty or what she desired to do with her estate. We find this fact curious, especially considering that the will [the attorney] provided

decedent was transcribed from a document decedent had purportedly dictated to her sister, Zuzan. Common sense suggests that at least some minor detail might have been lost in translation between decedent, Zuzan and [the attorney]. Further testimony established that when [the attorney] left the hospital room, decedent fell back asleep within 'a few minutes.'

Ehrhardt Will, 2 Fid. Rep. 3d at 415.

Although the Court held that Decedent lacked testamentary capacity and could have sustained the appeal from probate on that issue alone, the Court further addressed the undue influence issues presented by the matter and concluded that the proponent of the purported will also exerted undue influence upon Decedent which served as an additional basis to sustain the appeal from probate.

As most practitioners in this field know, the petitioner in *Ehrhardt* bore the burden of proving undue influence indirectly, and had to prove by clear and convincing evidence that the proponent of the will was in a confidential relationship with the testator, the proponent received

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Case Summaries, continued

a substantial benefit under the will, and the testator had a weakened intellect at or around the time the will was executed. A confidential relationship “is created when one person occupies a superior position over another intellectually, physically, or morally, with the opportunity to use that superiority to the other’s disadvantage.” *Id.* at 416 (citations omitted)

The court held that the proponent of the will, Decedent’s daughter, was in a confidential relationship with Decedent because Decedent granted her a power of attorney three days before her will was executed. Although the power of attorney, by itself, did not establish the existence of a confidential relationship, the proponent of the will subsequently engaged in conduct that established the confidential relationship. She handwrote Decedent’s will without telling the attorney she retained to prepare Decedent’s purported will, named herself beneficiary on both of decedent’s IRA accounts, and retrieved a laptop, jewelry, and financial documents from Decedent’s house. She failed to tell the attorney about Decedent’s recent bouts of delirium, closed two bank accounts in Decedent’s name, and took care of bills and phone calls on Decedent’s behalf. As with many malefactors, Decedent’s daughter did not let any grass grow under her feet before she started moving the money around – classic conduct of a bad actor. Therefore, the Court concluded that a confidential relationship existed at the time the will was executed.

The Court quickly concluded that the receipt by the proponent of Decedent’s personal and residuary estate, valued at no less than \$500,000,

constituted a substantial benefit to the proponent.

Lastly, and unsurprisingly in light of the Court’s finding of lack of testamentary capacity, the Court concluded that Decedent suffered from a weakened intellect when the will was executed, for the same reasons noted above in connection with the discussion of the testamentary capacity issue. Because the contestant also satisfied all three prongs test and thereby established the presumption of undue influence, and because the proponent of the will could not rebut that presumption, the Court set aside the Decree of the Register of Wills admitting the proffered will to probate.

The *Ehrhardt Will* matter reminds us all of some critical issues we often see in will contest actions. The scrivener received a fax directing him to prepare a will for a person he had never met. Although the scrivener met with Decedent before she signed the Will, because the scrivener had no prior relationship with Decedent the Court concluded that the scrivener was in no position to comment on her health prior to her final illness, and the scrivener of course had no prior knowledge of Decedent’s prior estate plan or intentions. If you receive a call, fax or email from someone asking you to prepare a will for a third party immediately, and especially if the person who contacts you purports to tell you the terms of that proposed will, then proceed with utmost caution lest you find yourself in a witness chair answering uncomfortable questions.

***Bortz Estate*, 2 Fid. Rep. 3d 342 (O.C. Westmoreland 2012)**

An issue that arises from time to time in connection with decedents’ estates is whether a surviving spouse (or parent) has forfeited his or her right to inherit from a decedent’s estate by “abandoning” or “deserting” the now deceased spouse or child for at least

one year prior to death. A recent opinion of the Westmoreland County Orphans’ Court reminds us that spouses are free to determine for themselves their living arrangements and interactions, and that even spouses who live apart for many years will not forfeit their inheritance rights absent proof of deliberate, non-consensual abandonment.

Under Pennsylvania law, “a spouse who for one year or upwards previous to the death of the other spouse, has willfully neglected or refused to perform the duty to support the other spouse, or who for one year or upwards has willfully and maliciously deserted the other spouse, shall have no right or interest under this chapter in the real or personal estate of the other spouse.” 20 Pa. C.S. § 2106(a). As the *Bortz* Court noted, in Pennsylvania, “desertion is ‘without cause or consent’ if there is evidence that 1) the spouse intended to desert; 2) the separation was non-consensual; and 3) the deserting spouse did not have legal cause to do so.” *Bortz*, 2 Fid. Rep. 3d at 343 (citing *Fisher Estate*, 276 A.2d 516, 519-20 (Pa. 1971).

In *Bortz*, Decedent and his wife married in 1962, and moved into Decedent’s family’s Pennsylvania farmhouse with his parents and sister. After a disagreement with the Decedent’s mother three years into the marriage, Decedent’s wife moved to Florida to live with her parents. At that time she agreed to move back in with her husband when he secured a home not located on her in-laws’ property. Shortly thereafter the husband complied with his wife’s ultimatum, and the wife returned to Pennsylvania and the couple lived together for eleven years in a rented home before returning to the family farm where they lived in a trailer.

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Case Summaries, continued

After Decedent admitted to an affair, and in light of ongoing tensions with her in-laws, which presumably resulted from again living on their property, Decedent's wife again moved back to Florida. After he apologized, Decedent's wife agreed to return to live with him only after both of his parents died.

Although Decedent's mother died 15 years later, Decedent's wife did not move back in with him at that time, and in fact never again lived with her husband before his death. Decedent died intestate, with no children, and under Pennsylvania law, Decedent's wife would have been the sole intestate heir. Petitioner, Decedent's sister, with the support of two other family members who would have been intestate heirs if the wife forfeited her intestacy rights, argued that Decedent's wife deserted her husband when she did not return to live with him after his mother's death.

In describing the unconventional marriage at issue, the Court determined that, although they lived apart for many years prior to Decedent's death, the couple maintained "a distantly intimate, and somewhat secretive, relationship" despite the fact that they never lived together again. *Id.* at 344. Telephone records showed lengthy, frequent conversations between Decedent and his wife. Though they saw each other face-to-face infrequently, many love notes, gifts and other "tokens of affection" were exchanged between the parties, "clearly evidencing their love for one another and confirming their special relationship as husband and wife." *Id.* Additional evidence presented confirmed that Decedent paid for his wife's medical insurance premiums, identified his wife

as his wife and beneficiary on his individual retirement accounts and other investment and bank accounts, and that both Decedent and his wife identified themselves as married in other financial dealings. *Id.* at 345.

The Court encapsulated the heart of the Petitioners' arguments on the abandonment issue and the Court's reasons for rejecting them:

The petitioner contends that [the wife] selfishly chose to stay in a comfortable home in Florida, willfully refusing to return to the marital home and to the accompanying obligations of life on the Bortz farm. However, [the wife] began to suffer physical symptoms from a debilitating disease [Lyme's Disease] as early as 1994, and we can infer from the record established that the home conditions in Florida were better suited for a woman with her disabilities than the meager living conditions available at her husband's home. In addition, [Decedent] worked two jobs, one of which was the demanding job of a farmer, so his availability to act as her caretaker was limited.

Id. For all of the reasons noted above, the Court held that Decedent's widow had not abandoned her husband, and that the widow was the proper sole intestate heir of Decedent's estate.

Although not an issue in *Bortz*, I note that Issues of "abandonment" and "forfeiture" of inheritance rights often arise in the context of a verdict or settlement of tort litigation on behalf of the estates of parents or children. When large sums of money appear, long-estranged parents or siblings have a tendency to arrive, hat in hand, proclaiming their profound sorrow at

the death of their family member and, by the way, looking for their share of the proceeds. Practitioners confronted with such a situation are wise to familiarize themselves with the governing law so that they will understand just how difficult it is to convince a court to invoke 20 Pa. C.S. § 2106 and find that the alleged abandonment has resulted in a forfeiture of inheritance rights. The law and the Courts recognize that, as they say, "every family is different," and will hesitate to take the drastic step of eliminating inheritance rights absent compelling proof that it is warranted.

Bortz is particularly instructive to litigators who wish to rebut a claim of abandonment – research the facts of the matter and determine whether you can locate and present evidence (such as the telephone and financial records discussed above) to support a claim that in fact Decedent maintained a clandestine relationship with the surviving spouse/parent/child. Surviving relatives who present themselves in your office often believe that they know the whole story, and they may even present you with a compelling story line, but decedents don't always share the secrets of their lives with all of their relatives, and they often leave secrets behind that a good attorney can uncover.

Practice Points

By BERNICE J. KOPLIN
SCHACHTEL, GERSTLEY, LEVINE & KOPLIN, P.C.

The Office of the Register of Wills in Philadelphia installed e-filing approximately a year and a half ago. One aspect of the new e-filing system generated some confusion and it is the purpose of this column to describe and explain how it has been remedied and how. When e-filing was initially installed, there was no way for the attorney who represented the estate to sign the petition electronically. Thus, the attorney was required to physically sign the petition in order to enter his appearance. If the attorney did not accompany the client to the Register's Office for probate, it meant that the attorney would have to go to the Register's Office at some other time to sign the petition for probate. If the attorney's appearance was after the letters were granted, a \$75.00 fee was charged.

In early December 2012 the following was added to the e-filing petition:

“ELECTRONIC SIGNATURE

By checking this box, I hereby agree to formally enter my appearance as Counsel for the Executor/ Administrator. In consideration of the granting of Letters Testamentary/ Letters of Administration to my client(s). I hereby agree, during such time as I serve as Counsel, that no funds will be distributed by the Executor/ Administrator, or any distribution made until all fees due to the Office of the Register of Wills, Philadelphia County, have been paid.

Electronically Sign Document”

While this revision to the e-filing site should resolve the problem, it is important to note that the Register will continue to charge a \$75.00 fee if an attorney enters his or her appearance after letters are granted. If a petitioner appears at the Register's to probate without the attorney, but the attorney enters his or her appearance while the file is pending (and this may be done electronically), then this charge will not be applied. But the Register's Office has explained that once the letters are granted and the attorney's appearance then entered, the fee covers the expense of having to change and or reissue the paperwork.

ED. NOTE: Readers are encouraged to send their questions or ideas for consideration in future columns to Bernice J. Koplin at bjkoplin@sglk.com.

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:

David A. Ruben
email:
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ETHICS COLUMN

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



You successfully defended your client in a paternity suit and counseled him with respect to an adulterous affair that continued until his death. He had repeatedly told you he wished to keep his sordid background from his daughter, his only child. He died a widower survived by his daughter. His daughter, whom you have never represented, is the executrix of his Will and has asked you for all of his files. How do you respond?

One of the bedrock principles of the client-lawyer relationship is the obligation of a lawyer to maintain a client's confidences, and that duty survives the client. Rule 1.6(d) of the Rules of Professional Conduct provides that the "duty not to reveal information" relating to the representation "continues after the client-lawyer relationship has terminated". See also the Restatement (Third) of the Law Governing Lawyers, §60 comment (e)(2000).

Once appointed, however, the executor or administrator of the deceased client's estate generally steps into the shoes of the client and may decide whether confidential information may be disclosed and any applicable attorney-client privilege asserted or waived. This would seem logical because a client is deemed to own the lawyer's file and an executor would seem empowered to claim the files on the decedent's estate's behalf. The ACTEC Commentaries (2006), published by The American College of Trust and Estate Counsel, commenting on Rule 1.6 suggests that consent to disclosure of a deceased client's confidences may be given by the decedent's personal representative.

If the confidential information relates in any way to existing

litigation, the lawyer would usually be obligated to release the relevant portion of his estate planning or other files containing confidential information that is related to that litigation if such is authorized or demanded by the executor or would be consistent with the deceased client's wishes or would carry out the deceased client's intent.

But there are some occasions when a lawyer would seem to have a right, indeed, an obligation, to resist an executor's demands for the file or authorization to release the file. For instance, suppose there is confidential information that reveals the decedent had planned to divorce her husband but had decided against it just prior to her death. Or perhaps the decedent had a checkered past that she had managed to conceal for her entire life and specifically requested that the lawyer not disclose to her family. Should an executor have an unfettered right to gain access to that information?

There is little guidance available for a lawyer faced with this dilemma. Philadelphia Bar Association Ethics Opinion 2003-11 opined that an attorney who represented a client who committed suicide during the representation could not disclose, pursuant to Rule 1.6, information related to the representation to the deceased client's father. Although the deceased client's

father was not the executor, the Opinion volunteered that, had the father been the executor, the father "would be authorized to consent to the disclosure of confidential information and information relating to representation of the client." However, the Opinion also included the admonition that: "The inquirer should be cautioned that confidentiality of information is a fundamental principle in the client-lawyer relationship. It is important that the inquirer limit disclosure of information relating to the representation of the client to that which is necessary to protect or assert the actual or potential rights of the decedent's. Furthermore, if the inquirer is aware through his representation that the deceased client would not consent to the revelation, then the information should not be disclosed to anyone."

Ethics Committees in two other jurisdictions faced a similar situation and issued opinions that are consistent with that caution and provide specific guidance. The Nassau County (NY) Committee on Professional Ethics issued Opinion No. 03-4 (2003) and the District of Columbia Committee issued Opinion 324 (2004) which provided similar responses to lawyers who held files of deceased clients and were faced with

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Ethics Column, continued

the request for those files by an executor/spouse. In the New York matter, it appears the executor/spouse had learned his deceased wife was contemplating a divorce. Both opinions held the executor/spouse should not have an automatic right to the files.

The D.C. Committee concluded in its Opinion 324 that: "When a spouse who is executor of a deceased spouse's estate requests that the deceased spouse's former attorney turn over information obtained in the course of the professional relationship between the deceased spouse and the former attorney, the former attorney may provide such information to the spouse/executor, if (1) the attorney concludes that the information is not a confidence or secret, or, (2) if it is a confidence or secret, the attorney has reasonable grounds for believing that release of the information is impliedly authorized in furthering the interests of the former client in settling her estate. Where these conditions are not met, the deceased spouse's former attorney should seek

instructions from a court as to the disposition of materials reflecting confidences or secrets obtained in the course of the professional relationship with the former client."

This would seem wise advice for a lawyer contending with an executor's persistent requests for or authorization of the release of any sensitive information the lawyer believed the client would not want disclosed. This would certainly seem so if it is clear the executor has a conflict of interest or is not acting in the best interest of the estate. In such instances, and particularly when it is possible to withhold a portion of the file or redact portions of documents, the lawyer holding the file should seek the intervention of a court, possibly by seeking a protective order, and suggest the confidential material be reviewed in camera by the Judge to determine whether the request for the disclosure should be denied.

In summary, when faced with the choice between protecting confidential information and observing the rights and power of the executor, a lawyer is best advised to allow a court to make the decision.

TAX UPDATE

By MARGERY J. SCHNEIDER,
ESQ.
ROSENN JENKINS
& GREENWALD, LLP

AMERICAN TAXPAYER RELIEF ACT (ATRA)

ATRA, effective January 1, 2013, makes permanent the federal estate, gift and GST tax laws. They are no longer scheduled to "sunset" in the future. ATRA contains the following provisions:

Federal Estate Tax: for estates of decedents dying after December 31, 2012

- The highest marginal Federal Estate Tax rate is 40%.
- The Federal Estate Tax exclusion amount is \$5,000,000, adjusted for inflation (\$5,250,000 in 2013).
- The portability election of unused estate and gift tax exclusion between spouses is made permanent. The term "applicable exclusion amount" is substituted for the term "basic exclusion amount" in the IRC § 2010(c)(4)(B).
- The deduction for state estate, inheritance, legacy and succession taxes under IRC § 2058 is extended.
- The deduction for family owned business interests ("QFOBI") has been eliminated.



WHAT WOULD YOU LIKE TO SEE IN FUTURE ETHICS COLUMNS?

Send your questions and ideas to:

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One Penn Center
19th Floor
Philadelphia, PA 19103

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Tax Update, continued

- The number of equity owners in a qualified business has been increased from 15 to 45 under IRC § 6166, deferred payments of Federal Estate Tax on closely-held business interests.
- The 5% surtax on estates larger than \$10,000,000 has been repealed.
- The rules concerning the estate tax deduction for conservation easements under IRC § 2031(c) have been liberalized.
- A waiver of the statute of limitations on certain special use valuation of farm real estate under IRC § 2032A has been added.

Federal Gift Tax: for gifts made after December 31, 2012

- The Federal Gift Tax rate is 40%.
- The Federal Gift Tax exemption amount is \$5,000,000, adjusted for inflation (\$5,250,000 in 2013).

Generation-Skipping Transfer Tax (GST):

- The unification of the Federal Estate Tax and GST tax exclusion amount is made permanent.
- The following GST tax simplification provisions are made permanent:
 - Automatic allocation of the GST tax exemption to “indirect skips” and related elections with respect to GST trusts under IRC § 2632(c)

- Retroactive allocation of GST tax exemption in the case of “unnatural order of deaths,” under IRC § 2632(d)
- Modification of valuation rules with respect to the determination of the GST inclusion ratio under IRC § 2642(b)
- Qualified severance rules under IRC § 2642(a)(3)
- Relief from late or incorrect GST allocations and elections under IRC § 2642(g)

FEDERAL ESTATE TAX

Family Limited Partnerships

Keller v. U.S., (2012, CA5) 110 AFTR2d 2012-6061 (September 25, 2012)

The Court of Appeals for the 5th Circuit, ruling against the IRS, affirmed the District Court’s holding in the taxpayer’s favor in *Keller v. U.S.*, 2009 WL 2601611 (S.D. Tex., August 20, 2009). [A summary of the lower court case can be found in *Tax Update*, Winter 2009-2010.] The Court stated that under Texas law, a partner’s intention to transfer property to a limited partnership causes the asset to be partnership property, even if some of the formalities of the transfer are lacking. The Court affirmed the large valuation discount approved by the District Court and allowed the deduction of interest on the Graegin loan from the FLP to the estate to pay estate taxes, reasoning that the loan was necessary because the payment of estate taxes was an obligation of the estate and not of the FLP.

Marital Deduction in Same-Sex Marriage

Windsor v. U.S. (2012, CA2) 110 AFTR2d 2012-6370 (October 18, 2012)

The Second Circuit Court of Appeals affirmed the holding for the taxpayer in *Windsor v. U.S.*, 109 AFTR2d ¶ 2012-870 (DC N.Y. 6/6/2012), in which the District Court for the Southern District of New York held that the estate tax marital deduction is available to same-sex couples. The Second Circuit Court, applying intermediate, or “heightened” scrutiny to § 3 of the federal Defense of Marriage Act (as opposed to the “rational basis” standard of review applied by the District Court), held that it was unconstitutional because it violated the Equal Protection Clause of the U.S. Constitution.

On December 7, 2012, the Supreme Court granted certiorari in the case.

Allowance of Deductions

Estate of Derksen v. U.S., Civil Action No. 11-4549, U.S. District Court, E.D. PA (November 8, 2012)

The Court affirmed the disallowance by the IRS of an estate tax deduction for a debt owed by a decedent spouse to her husband’s estate.

Two months before Marion Derksen’s husband died in 1997, Marion executed a \$200,000 promissory note to him, ostensibly for the purpose of equalizing their estates. The note, was listed as a receivable on his estate. Several months later, she made out a check to the estate for that amount, but the check was never deposited and the funds never transferred. Marion died in 2001. The federal estate tax return claimed a deduction of \$200,000 for the debt. The IRS denied the deduction because of lack of consideration for the agreement creating the debt. In fact, the testimony of their daughter as to her understanding that her parents intended to equalize their estates was the only evidence of any formal agreement.

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Tax Update, continued

The Court found that there was no evidence of a genuine contractual agreement supported by adequate consideration, as is required in order to deduct the debt of an estate under IRC § 2053 and 26 CFR § 20.2053-1(b)(2)(ii). Furthermore, although the \$200,000 was consistently reported for tax purposes, the Court considered that this evidence was not sufficient to outweigh the indications that no contractual agreement existed, especially since no funds were actually transferred. The Court emphasized that contracts among family members are carefully scrutinized.

Estate of Bates v. Comm'r, T.C. Memo. 2012-314 (November 7, 2012)

The Tax Court ruled that an estate could not deduct the cost of settling a claim concerning a beneficiary's distributive share, because the beneficiary could not be considered a creditor.

In 1998, the decedent executed a trust including a \$100,000 pecuniary bequest to her caretaker. She executed an amended and restated trust seven years later, which provided that the caretaker would serve as executor and trustee and would receive one-half of the trust income. When the decedent died, her granddaughter submitted the first will for probate and the caretaker submitted the second. The parties eventually settled their disputes. The second will and trust were adjudicated invalid and the caretaker received \$575,000. The estate attempted to deduct the funds paid to the caretaker in the settlement.

The IRS disallowed the deduction and the Tax Court agreed. The Court cited IRC § 2053, which provides that a claim is deductible if it is based on adequate consideration and not attributable to the decedent's testa-

mentary intent. Here, the caretaker, as a beneficiary named in both the first and second trusts, could not be considered a creditor. He had been fully paid for his lifetime services and had not filed a claim for unpaid compensation.

LATE PAYMENT OF ESTATE TAX

Estate of Thouron v. U.S., E.D. Pa., No. 2:11-cv-04058 (November 8, 2012)

The Court held that reliance on the advice of a tax attorney was not reasonable cause for late payment of Federal Estate Tax.

The executor of a decedent's estate hired an attorney to provide tax advice. The executor, relying on the attorney's advice, timely filed Form 4768, Application for Extension of Time to file a Return and/or Pay U.S. Estate Taxes, but requested only an extension of the time to file the return and not a request for an extension of time to pay the tax. The executor claimed that the attorney advised him that the tax due would be deferred under IRC § 6166 because the bulk of the estate consisted of illiquid assets. When, six months after the initial nine-month deadline, the estate filed Form 706 and also submitted a request for an extension of time to pay the tax, the IRS denied the request and assessed a late-payment penalty of \$999,000.

The Court strictly applied the Supreme Court's ruling in *U.S. v. Boyle*, 469 U.S. 241 (1985), citing its statement that people who are not tax experts should be able to "ascertain a deadline and make sure that it is met."

FEDERAL GIFT TAX

Formula Clauses

Wandry v. Commissioner, IRS Action on Decision, IRB 2012-46 (November 13, 2012)

The IRS issued an Action on Decision (AOD) concerning *Wandry*,

T.C. Memo 2012-88 (March 26, 2012), which deals with the use of formula clauses in gifting. The Tax Court had held for the taxpayers, ruling that the formula clause in question successfully limited and fixed the value of the gift of LLC shares at the time it was made and did not attempt to reverse a prior completed gift. In the AOD, the IRS announced that it does not acquiesce in the decision and will not follow the holdings of the Tax Court.

The AOD distinguished *Wandry* from *Estate of Petter v. Commissioner*, 653 F.3d 1012 (9th Cir. 2011), in which a formula allocation clause was used to allocate the value of the gifted asset between a trust and a charity. The formula used in *Wandry* was a formula transfer clause, in which it was possible that a valuation adjustment to the underlying property for gift tax purposes could change the allocation of units between the donee and the donor. The IRS observed that in *Petter*, unlike in *Wandry*, there was no contingency and therefore no possibility that membership interests would need to be reallocated to the donor.

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2012 COMMITTEE REPORTS

Business Planning Committee

DENNIS C. REARDON, CHAIR

In 2011 and the first few months of 2012, the Business Planning Committee held monthly meetings on various topics pertaining to business continuation and succession planning for closely held businesses. However, regular meetings were not held in the second half of 2012. I plan to hold a meeting in the first quarter of 2013, with the thought that year-end was particularly busy this year, so it's better to wait.

Along the way, we had meetings on various subjects in which the discussion was active and a small core of regular attendees was emerging. However, more need to be done, and perhaps different approaches should be followed. I welcome any feedback from anyone on the Executive Committee or in the Section, generally. In the meantime, I offer these thoughts:

- Perhaps our meetings should be quarterly or bimonthly. More thought and preparation might go into each meeting, and more opportunity for attendees to recruit others who may be interested in attending.

- I believe that law firms vary as to whether business succession planning primarily happens through the Trusts and Estates group, or whether it is done more frequently through the Corporate group, or whether a Wealth Advisory group might conduct it. In this report, I'm asking for feedback as to whether Executive Committee members have partners and associates interested in the topic, and whether they might attend, even if they have only peripheral exposure to estate planning.

- I plan to inquire further with the Bar's Business Law Section and Tax Section to see whether business planning topics for closely held businesses are more often conducted within those Sections, and, if so, how to create synergy of some kind.

- Business succession planning, in particular, often involves other professionals, some of whom many of us see at the Philadelphia Estate Planning Council, for example. Earlier in the year, we had a meeting in which an experienced business appraiser made an excellent presentation. Maybe we should reach out more to CPAs, investment advisers, financial planners, etc.

- It's probably a good idea to submit an article to the Section's newsletter. I'll be glad to do so, but we'll need other volunteers along the way. Periodic articles can only help to generate more interest and activity over time.

Publications Committee

DAVID A. RUBEN, CHAIR

*The Publications Committee meets three times a year
at Saul Ewing LLP, Center Square West, 1500 Market Street, 12th Floor.*

During 2012, the Publications Committee continued with its mission of producing three informative Newsletters per year. We are fortunate to have had a number of members of the Section write for us on a wide variety of topics.

We are always looking for timely and interesting articles, and welcome contributions from Section members, as well as others engaged in related areas of work. We invite Section members to suggest ways in which the Publications Committee may better

serve the needs of the Section. To join the Committee, submit an article or make a suggestion, please email David at david.a.ruben@ubs.com

Education Committee

LAURA E. STEGOSSI, CHAIR

The Education Committee meets on the third Tuesday of the month at 4 p.m. at Weber Gallaher Simpson Stapleton First and Newby LLP, 2000 Market Street, Suite 1300

The Education Committee meets eight times a year to discuss current topics relevant to the Section. Those topics become the basis for three programs (March, June and October) that provide CLE credits for program attendees. The Committee is responsible for choosing topics, outlining the content of the programs, and then selecting and recruiting qualified panelists to make a two-hour presentation at the quarterly meetings. After the presentations are completed, the Committee reviews the evaluations that are generated from the program attendees and utilizes those evaluations to improve upon future programs.

In 2012, The Committee organized the following programs:

“The Pennsylvania Uniform Trust Act: Where are We Now?”; “Estate Planning Issues Facing the Contemporary American Family -- Same-Sex and Unmarried Couples”; and “Orphans’ Court for the Estate and Trust Practitioner.”

As always, the group’s accomplishments are made possible by the excellent work of our dedicated planners, and the diligent effort and generous contribution of time made by the panelists.

The Committee welcomes suggestions for future program topics, and any interested Section members are encouraged to join the Committee by contacting Laura Stegossi at (215) 972-7918 or lstegossi@wglaw.com.

Legislative Committee

MICHAEL R. STEIN, CHAIR

The Legislative Committee meets on the second Wednesday of the month at 4 p.m. at Pepper Hamilton LLP, 3000 Two Logan Square, 18th and Arch Streets.

The Legislative Committee began 2012 by preparing informal comments regarding the Uniform Adult Guardianship and Protective Proceedings Act. Subsequently, the Committee reviews its prior analysis and recommendations regarding the Uniform Management of Institutional Funds Act (UPMIFA). The Committee clarified its recommendations and submitted a revised informal report on UPMIFA to the Joint State Government Commission.

Presently, the Legislative Committee has two subcommittees working to analyze and prepare draft legislation for further consideration.

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Elder Law and Guardianship Committee

NANCY LEWIS, RISE P. NEWMAN AND HOWARD SOLOMAN, CHAIRS

The Elder Law and Guardianship Committee meets on the fourth Thursday of the month at 1 p.m. at the Philadelphia Bar Association, 1101 Market Street.

The Committee chairs offered practitioners a wide range of topical meetings. In the late winter, we were honored to have Dionysios C. Pappas, Esq., present a detailed discussion and several case studies concerning veterans benefits for the aging population. In June, a panel consisting of Howard Soloman, Esq., Adam Bernick, Esq., Pat Rowan of PNC Bank and Joanne Shallcross of

PNC Bank, raised and helped us dissect issues with guardianship and Special Needs Trust cases. In September, Ja-eun Lee, LSW and Clinical Care Coordinator with The Alzheimers’ Association discussed issues concerning this grave illness and the available resources. In October, Noel De Santis, a Philadelphia ADA, gave a well-received and energetic presentation on her work with elder abuse cases.

The Committee endeavors to present speakers who can include in their presentations information that will be of interest and help to attorneys at different levels of practice. The 2013 chairs, Nancy Lewis, Howard Soloman and Adam Bernick, are sure to continue the excellent and timely programming the Section has come to expect. All comments and meeting suggestions are welcome.

Tax Committee

REBECCA ROSENBERGER SMOLEN, CHAIR

The Taxation Committee meets on the fourth Tuesday of the month at 8:15 a.m. at various locations.

The Tax Committee has had a busy year addressing both traditional topics and cutting edge issues.

At our January meeting, we covered reports from the Heckerling Institute, Recent Developments in Pennsylvania tax law governing the realty transfer tax imposed on transfers to trusts and proposed inheritance tax reporting requirements and imposition of tax for terminations of certain trusts. During that meeting we also discussed topics for meetings for the balance of the year.

We focused on trust decantings, and request for comments by the IRS in Notice 2011-101 on the appropriate tax treatment of such events, during our February Meeting. At our next meeting in March, we focused on planning ideas and issues for tax provisions that are set to expire at the end of 2012. Then, in April, Jonathan Samel gave a presentation on planning issues related to Marcellus Shale interests.

During our May meeting, we had a panel presentation about issues surrounding estate planning with qualified retirement benefits with contributions by myself, Tom Hiscott, and a lawyer from Vanguard, Andrea Wasser. In June, we had another panel presentation addressing unique tax planning issues arising under New Jersey Law (Glen Henkel) and Delaware Law (Jocelyn Borowsky).

After a summer break for July and August, our September meeting was comprised of a presentation by Richard Fox surveying Selected Topics in Philanthropy & Exempt Organizations.

Our last meeting of the year was a repeat visit from a panel of representatives (Mary-Jo Mullen, Bill Lyons, Tom Gohsler and Laurie Fulmer) from the Pennsylvania Department of Revenue addressing Inheritance Tax issues where many of us learned for the first time about the recently updated Schedule "O" for the Pennsylvania In-

heritance Tax Return to implement the Department of Revenue's new controversial policy related to potential terminations of sole use trusts prior to the death of the surviving spouse.

For the second year in a row, the IRS passed on our invitation to address the Probate Section in November, but, we remain hopeful that next year they will resume their traditional annual meeting with us.

I'd like to thank all of our fabulous presenters over the course of the year for their help in making our meetings interesting and educational. A special thanks to Marguerite Weese, who, in her role as Secretary of the Tax Committee, has helped to coordinate all of our meetings and prepared timely tax updates for each of our meetings as well as to Marjory J. Schneider for preparing the quarterly updates for both our Newsletter and Section's Quarterly Luncheon CLE programs/Meetings.

Legislative Committee report, continued

One subcommittee is concentrating on a statute pertaining to the appointment, authority and liability of directed trustees, as well as the advisors who will provide the direction. The other is focusing on a statute pertaining to fiduciary authority to access and/or distribute digital assets and the digital accounts of a decedent, such as documents stored on the cloud and access to social media accounts.

Orphans' Court Litigation and Dispute Resolution Committee

TIMOTHY J. HOLMAN, CHAIR

The Orphans' Court Litigation and Dispute Resolution Committee meets on the second Tuesday of the month at 8:30 a.m. at Smith Kane LLC, One Liberty Place, 1650 Market Street, 36th Floor

The Orphans' Court Litigation and Dispute Resolution Committee enjoyed a great year during which it continued to discuss recent developments in the law and procedure governing Orphans' Court litigation, practice before the Orphans' Court, and alter-

native dispute resolution techniques, and to promote collegiality among practitioners of fiduciary litigation. Among the interesting topics we discussed were: (1) the attorney-client privilege in general and as it pertains

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Rules and Practice Committee

BERNICE J. KOPLIN, CHAIR

The Rules and Practice Committee meets three times a year at Saul Ewing LLP, Center Square West, 1500 Market Street, 12th Floor

The Rules and Practice Committee continued its work this year on drafting three proposed rules (2039.1, 2064.1, and 2206.1) to replace Joint Court Regulation 97-1, the Procedures for Approval of Compromises involving Minors, Incapacitated Persons, Wrongful Death and Survival Actions. The proposed rules will be passed to the Executive Committee of the Section at its January 2013 meeting.

Our Committee's work would be impossible to accomplish without the dedication of our committee's members. My personal thanks to all of the committee members for their time, thoughtful consideration and dedication to the work of the Section, and the Committee wishes to express special thanks to the Orphans' Court Division judicial clerks, Joseph P. Campbell, Maryanne Finigan, and Nancy Eshelman for their involvement and assistance.

Four new members joined the Committee this year, but more are always needed and welcome, and suggestions for projects are welcome from the Section as well. Our committee meets on the second Tuesday of the month at 4:00 P.M. in the offices of Schachtel, Gerstley, Levine & Koplin, P.C., 123 South Broad Street, Suite 2170, Philadelphia, PA 19109-1022, and members are also welcome to attend by conference call.

Litigation and Dispute Resolution Committee, continued

to fiduciary litigation matters – especially in matters involving fiduciaries and their counsel; (2) the use of expert witnesses in surcharge litigation (thanks to Committee member James Mannion, Esquire, for a great talk on that topic); (3) sealing the record in Orphans' Court litigation matters; (4) whether and in what circumstances to file exceptions to an Orphans' Court ruling (thanks to Committee member Adam Gusdorff for sharing his wisdom with our Committee); (5) electronic discovery, and in particular the recent amendments to the Pennsylvania Rules of Civil Procedure which now specifically address the discovery of electronic information - which will surely increase in light of the electronic communication age in which we live; and (6) litigation regarding counsel fees and fiduciary commissions (thanks to Committee member Tom Boulden for speaking to our Committee on those important issues). We also ended our year with

a fascinating "round table" discussion with Joseph Campbell, Esquire, and Maryanne Finigan, Esquire, who, of course, are the law clerks for Judges O'Keefe and Carrafiello, respectively, at which Mr. Campbell and Ms. Finigan offered sage advice on how to avoid common mistakes/problems they see on a regular basis. I am grateful to Mr. Campbell and Ms. Finigan (and Judge Herron's law clerk, Nancy Eshelman, Esquire, who unfortunately could not attend the meeting due to a death in her family), for sharing their wisdom with our Committee and strengthening the bonds between the bench and the bar.

We also contributed articles to the Probate Section's Quarterly Newsletter on recent Orphans' Court cases of interest to the Section.

I am thankful for the input and participation of the dedicated members of the Committee, whom I thank for their time and their work on behalf of the Section. I also thank sincerely Committee member and my now former colleague Brad Terebello for his invaluable assistance during the past few years. Although Brad will, mercifully

for him, no longer be at my beck and call, we are fortunate to have him as a member of our Committee and of our Section.

New members are always welcome. We meet on the second Tuesday of January, February, March, May, June, September, October and November at 8:30 a.m. at the office of Smith Kane, LLC, at One Liberty Place, 1650 Market Street, 36th Floor, Philadelphia, Pennsylvania (the "Regus" space). All members of the Probate & Trust Section are welcome at our meetings, and are also welcome to contact the Chair at any time to discuss joining the Committee or to raise any issues which may be of interest to the Committee. I can be reached by phone at 610-518-4909, or by email at tholman@smithkanelaw.com.



The PEPC invites the Philadelphia Bar Association Probate and Trust Law Section to join our Council for membership and programming!

February Luncheon Program

February 19, 2013

11:45 a.m. - 1:45 p.m.

The Union League

140 S. Broad Street, Philadelphia, PA

Topic: "Let My Trustees Go! Planning to Minimize or Avoid State Income Taxes on Trusts"

Speaker: Richard W. Nenno

March Breakfast Program

March 19, 2013

8:00 a.m. - 10:00 a.m.

The Union League

140 S. Broad Street, Philadelphia, PA

Topic: "Going Up for the Rebound"

Speaker: Anirban Basu

2013 Annual Meeting

May 9, 2013

4:30 p.m. – 9:00 p.m.

The Barnes Foundation

2025 Benjamin Franklin Parkway, Philadelphia, PA

Topic: "The Life Cycle of Collecting, Owning and Ultimately Disposing of Artwork and Other Collectibles"

Speakers: Jo Backer Laird and Peter Stern

For more information on joining the Philadelphia Estate Planning Council or to register for any upcoming programs, please visit www.philaepc.org.