PHILADELPHIA BAR ASSOCIATION

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REPORT OF THE CHAIR

BY KAREN M. STOCKMAL, ESQ. | KMS LAW

I have just returned from the 2014 Philadelphia Bar Leaders Retreat at the Borgata Hotel in Atlantic City, New Jersey. While driving to the retreat, watching cars around me fishtail on the ice and snow, I thought several times about turning back. In my 14+ years of working in some capacity with the Probate Section, I have never had much interaction with the "Big Bar" and I felt like I was taking my life in my hands trying to do so now. The conversation in my head went something like, "Perhaps it's a sign. Perhaps I should turn back. I'm comfortable with the Probate Section. Who needs the Big Bar? Why am I risking life and limb to explore an unknown and possibly unwelcoming frontier?"

I made it to the retreat, and I have to say, I was pleasantly surprised. Although many of the attendees have been coming for years and were reconnecting, everyone was open and welcoming to those of us who were newcomers. I came in thinking, "The Big Bar isn't really relevant to the Probate Section. It is mainly for trial and business lawyers."

What I came away with was a very different feeling. In fact, the Big Bar is extremely relevant to the Probate Section. We need only take our seat at the table.

Three of our initiatives are actually identical to those of the Big Bar. These include reaching out to young lawyers through the Young Lawyers Division, reaching out to law students through our law schools, and exploring what diversity means and the benefits it brings to our legal community. Chancellor Bill Fedullo is actually taking it a step further and reaching out to Philadelphia public schools as well.

Mary Byers, author of *Race for Relevance: 5 Radical Changes for Associations*, spoke to the group and offered a number of interesting insights.

1. Microleadership works best. She posited that five is the optimal number for competency and efficiency in making group decisions while ensuring that each member takes ownership in the process.

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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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REPORT OF THE CHAIR, continued

2. Time. Because bar associations are governed largely by volunteers, I tis important to periodically evaluate whether participants' time is being used optimally. How many meetings do we hold and how many do we really need? Are we providing materials well in advance to allow for preparation? How much time is spent traveling to and from these meetings? Our volunteers are our biggest resource, and we need to spend their time even more carefully than our dollars.

3. Return on investment. What is the return that a member gets when they join the Big Bar and, by extension, the Probate Section? In other words, what are our selling points?

4. Generational expectations. Mary pointed out that Baby Boomers, Generation X'ers and the Millennials all communicate very differently. Are we accessible in ways that are effective and efficient for all of them?

5. Technology. Are we using the elements of technology to the best of our ability for all of our volunteers and our members? How much of our budget is focused on utilizing technology?

One additional thought that I found very thought provoking was not only should we be thinking about our "to do list" but shouldn't we also have a "we don't list"? What are we not going to do? Our resources are limited both in terms of dollars and volunteer time. How do we want to spend them?

So, this is a call for your input, for your energy and for your participation. Scott Small of Wells Fargo has graciously accepted the position of Liaison to the Board of Governors (i.e. the "Big Bar"). He will guide us as a Section in claiming the chair reserved for us at the table of the Philadelphia Bar Association and the legal community of Philadelphia. I look forward to working with him and with each of you in the coming year.

JOIN A COMMITTEE

The Section's Committees depend on the steady flow of people, energy and ideas. Join one! Contact the Section Chair:

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CHARITABLE REMAINDER TRUSTS AND PRIVATE FOUNDATIONS IN COMPREHENSIVE CHARITABLE PLANNING

BY KING MCGLAUGHON, JD, AND ANDREW SCHULZ, JD | FOUNDATION SOURCE

Often, charitable planning begins and ends with a donor wanting to make a particular size or type of gift to a specific organization. While this piecemeal approach to charitable giving is certainly feasible, an approach to gift planning that starts with a particular result in mind can overlook other opportunities. The trend among many advisors, therefore, is to integrate charitable giving into a comprehensive wealth management plan. This more holistic approach to philanthropy may ultimately produce larger gifts and a more satisfying experience for the donor and the organization(s) supported by the gift.

In order to effectively integrate charitable tools into the process of wealth management and estate planning, it is necessary to understand which ones can be used to accomplish the desired planning objectives. This article explores two options, charitable remainder trusts and private foundations, and how they can be used separately and in combination as part of a robust charitable planning process.[1]

Setting the Stage

Increasingly, Americans, particularly those with assets in excess of $1 million, are engaged in an ongoing process of financial, tax, asset, and wealth management that has become complex. Philanthropy and charitable giving then must also be managed within the context of this ongoing planning. If philanthropy continues to be addressed as a distinct, non-integrated decision, success in charitable planning will undoubtedly become less likely. An example will demonstrate this effect:

Jill Donor is 58 years old. She is married, has two grown children, and two grandchildren. She is CEO of a regional marketing company that she established 25 years ago and that now has a market value of $25 million. She has other assets, including her personal residence and a vacation home, with a total value of $5 million. She has retirement plan assets of almost $2.5 million. She has made many gifts to various charities over the years, the largest being a $50,000 gift to her alma mater as part of a capital campaign. Typically, she gives in the $1,000 to $2,000 range, and annually, she makes 15 or more similarly sized gifts to various organizations. Jill has implemented a complex and fairly sophisticated financial plan. She has established and funded a successful retirement plan, a revocable living trust, and a family limited partnership in which she and her two children hold shares. A significant portion of her non-business investment assets are tied up in an investment vehicle designed to "wash out" capital gains over an extended period of time for tax avoidance; those assets cannot be moved out of the strategy for 15 years without the imposition of financial penalties and the loss of tax avoidance on those assets. Jill's plan also allows for annual charitable gifts of no more than $50,000, which Jill and her advisor believe is generous, and which is funded through a particular income production strategy with some of her investment assets.

Jill is approached with a proposal to endow the marketing and communications department at her alma mater with a gift of $2 million. Although Jill would like to make this gift, it falls well outside her annual charitable "budget." Even if she decided to forego all other charitable giving and pledge her $50,000 each year to make the gift, her current financial plan would not allow her to meet the college's needs in a reasonable period of time. Jill sees no way to take advantage of the endowment opportunity. Instead, she agrees to

[1] A more detailed treatment of the subject of comprehensive charitable planning appears in "Putting it All Together: A Solutions-Based Approach to Charitable Planning and Tool Selection" published by The American

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make a gift of $25,000 this year and to increase her annual giving to the college to the level of $5,000 each subsequent year.

Jill has a net worth of over $30 million. Yet, because of the manner in which she holds her assets, the long-term planning and investing she has done, and the failure of her advisors to see philanthropy as an integral part of that planning, she believes that she is "unable" to make a gift that she would like to make, and that would amount to less than 10% of her net worth.

A More Comprehensive Solution

At best, for the traditional donor, charitable giving is an "expense" item in the annual budget, to be supported and maintained by unrelated income production strategies. The Jill Donors of the world have the financial means to do all the giving they would like to do, but their assets are allocated to planning and investment strategies that are only designed to meet current levels of giving. They are locked into strategies that fail to anticipate different levels or types of giving.

Philanthropy, not merely sustained annual giving, should be incorporated in the planning process from the outset. Advisors should understand the use and value of various charitable tools and techniques as integral components in an ongoing process of financial and wealth management.

To see how charitable remainder trusts and private foundations can augment traditional financial and estate planning, let's examine a few basic objectives. The components of traditional financial and estate planning can be distilled to the following:

- Produce income
- Reduce or eliminate taxation of income
- Position or reposition assets for either growth or income
- Protect assets from claims of creditors, family members, litigants, etc.
- Protect assets from potential adverse market conditions
- Transfer assets to particular individuals (heirs) or classes of individuals in a controlled manner
- Reduce or eliminate taxation upon the transfer assets to others
- Use and manage "philanthropic capital" effectively and efficiently
- Retain "control" over assets as they are incorporated into strategies with the foregoing purposes

Those who advise individuals in planning will need to identify which of these planning goals meet their clients' needs and then select the charitable planning tool that can be used to achieve one or more of these objectives. Looking at two charitable planning tools - the charitable remainder trust and the private foundation – and examining how each can be used to achieve specific goals within a broader plan, is illustrative of the point.

Produce income: Charitable Remainder Trusts, and to a limited extent, Private Foundations, can both be used to produce income to the donor or to other designated beneficiaries. The use of CRTs to produce income is obvious, but to determine whether they are appropriate or desirable tools, it is important to consider whether beneficiaries other than the donor will be named. In circumstances in which non-donor beneficiaries will be designated, it is critical to take into account issues of transfer taxation and regulatory limitation. For example, if Jill desires to fund the education of her grandchildren, it might be possible to create a CRT naming those grandchildren as income beneficiaries. In that case, the issue of current gift taxation of the trust funding should be considered.

The use of private foundations to produce income is less obvious. Under current law and regulations, the donor, family members, and other persons may receive income from the foundation in the form of reasonable salaries or other compensation for services performed for or on behalf of the

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foundation. If the long-term planning or philanthropic needs of the client would be satisfied or furthered by the creation and funding of a foundation, it would be possible that some level of income could also be generated in the future for particular individuals, provided they were willing and able to perform valuable services for the foundation.

In addition, a private foundation and a CRT may be combined, with the CRT providing income to beneficiaries now, and the foundation providing income in the form of reasonable compensation for services rendered when the foundation is fully funded, either at death or conclusion of the selected CRT term.

Reduce or eliminate taxation of income: Both split-interest gifts (funding a CRT) and outright gifts to a foundation allow the donor to claim income tax deductions that can reduce or eliminate the income tax liability of the donor. With a CRT, the donor receives a charitable deduction based on the actuarial present value of the charity's right to receive the corpus on termination of the noncharitable (income) interest. The CRT itself is also immune from taxation on income earned by the trust. However, tax is not avoided altogether because payments to the income beneficiary will be subject to tax at the time of distribution.

As with a CRT, a donor to a private foundation receives a charitable deduction against their income tax liability. The amount of that deduction, however, depends on the type of asset and whether it has appreciated or not. For cash and publicly traded securities, the deduction is based on the fair market value of the asset and is deductible up to 30% of the donor's AGI. Other assets, including closely held business interests, real estate, and appreciated personal property are only deductible based on the donor's cost basis in the asset and are subject to a lower limit of 20% of AGI. Because of these limits, careful consideration needs to be given to which assets are used to fund a private foundation.

Reposition assets for either growth or income: CRTs may be used to reposition assets for future growth and/or income production. In most cases, the use of a CRT to reposition assets will also protect the act of repositioning from taxation. For example, if a donor needs to reposition assets held for growth during earlier planning periods in order to produce higher levels of disposable income at the transition from working to retirement, the use of a CRT to produce the future income can reduce or eliminate capital gains tax erosion of the principal value of the gift. Because the CRT does not pay capital gains tax when it sells an asset, under current tax rules, that can mean a savings of between 15 and 43.4% percent of principal in the repositioning of assets for income production.

Protect assets from claims of creditors, family members, spouses, litigants, etc.: Both foundations and CRTs can protect gift assets from the claims of creditors, spouses, litigants and others. Assets transferred irrevocably to charitable entities are no longer the property of the donor, and are thus generally no longer subject to the claims of individuals against the original donor. However, in many states, transfers intended to defeat the legitimate claims of creditors after those claims have arisen may be set aside under various statutes designed to prevent fraud by obligors upon those to whom they are legally obligated. Likewise, while it may be possible to place assets in a CRT and protect the trust assets themselves from claims of creditors, creditors may nonetheless be able to obtain rights to the income interest of the donor/income beneficiary of the CRT.

Use and manage "philanthropic capital" effectively and efficiently: Both CRTs and private foundations manage "philanthropic capital" efficiently and effectively. However, only a private family foundation allows direct control of assets by the donor. IRS rules permit the donor to control the use of philanthropic assets, allowing great flexibility in how they are used to further particular philanthropic purposes. Because the trustee of a CRT must balance the interest of the income beneficiaries and the charitable (remainder) beneficiary, there are necessarily limitations on how the

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assets can be managed to further philanthropic objectives.

Very often, in strategic charitable planning of the type discussed here, an institutional philanthropy tool such as a private foundation is positioned in conjunction with other charitable and non-charitable tools in order to accomplish multiple planning objectives over time. For example, a CRT may designate the donor's private foundation as remainder beneficiary to accomplish both income production and asset protection goals. At the same time, a child or children can receive income as reasonable compensation for foundation work and the assets of the foundation can be used to support the charitable endeavors of the children, freeing their other personal financial assets for use in meeting their own non-charitable financial goals.

Another example, a highly appreciated asset may be contributed to a CRT with the private foundation as the charitable beneficiary, to maximize tax benefits, affording the donor a potentially greater deduction than if the asset were contributed directly to the foundation. The asset can continue to increase in value, immune from capital gain and income taxation, and still provide an income stream to the donor or another beneficiary.

Conclusion

Conversation within the client relationship must be redirected from product/service or issue-oriented transactions toward a more comprehensive discussion of goals and planning for the donor/client and the beneficiaries of the donor/client's generosity or responsibility. In many cases, given the complex nature of the tools and strategies involved in strategic philanthropic planning, it will be necessary for various types of advisors to work collaboratively with each other in support of the client's larger goals. In this regard, a cooperative relationship among all the donor's advisors, rather than a competitive engagement of the advisors with each other, will be more productive in the long run and ultimately more beneficial to all involved.

While the process of comprehensive philanthropic planning is complex, and in many cases foreign to both advisors and their donor/clients, this approach to philanthropy should result in more significant gifts over time than traditional approaches to charitable planning and fundraising. Further, and more importantly, this approach to philanthropy will allow individuals to realize their personal goals, both charitable and non-charitable. And finally, this approach to charitable planning will marshal "philanthropic capital" more efficiently and more effectively than less strategic and carefully coordinated approaches.

About Foundation Source

Foundation Source is the nation's largest provider of comprehensive support services for private foundations, bringing unparalleled knowledge and expertise to clients across the country. The company's administrative services, online foundation management tools and philanthropic advisory services provide a total outsourced solution for private foundations. The result: better-run, more effective foundations and more enjoyable philanthropy. Our clients supply the funds, the vision and the philanthropic goals; we provide everything else.

Today, Foundation Source provides its services to more than 1,100 family, corporate and professionally staffed foundations coast to coast, ranging in size from $250,000 to over $500 million. The company provides its services directly to philanthropically focused families and institutions as well as in partnership with the nation's leading private wealth management firms, law firms and accounting firms. Foundation Source is headquartered in Fairfield, Connecticut, with auxiliary locations in Atlanta, Chicago, Dallas, Denver, Los Angeles, New York City, Philadelphia, San Francisco, South Florida, and Washington, D.C.

PENNSYLVANIA INHERITANCE TAX EXEMPTION FOR QUALIFIED FAMILY-OWNED BUSINESSES: A BOON — WITH SOME OPEN QUESTIONS

BY EMILY PICKERING, ESQ. | COZEN O'CONNOR

Pennsylvania imposes an inheritance tax which can be significant. With rates ranging from 0% to 15%, depending on the relationship of the decedent to the recipient, this tax can deal a heavy blow to families where the main asset in an estate is a family business. Taking this into consideration, the Pennsylvania legislature enacted Act 52 of 2013. This Act, which took effect on July 9, 2013, exempts from Pennsylvania inheritance tax the transfer of qualified family-owned business interest to a qualified transferee for decedents dying on or after July 1, 2013.

There are two threshold questions to determine whether the transfer will qualify for the exemption:

1. Was the transfer of the qualified family-owned business interest made to a qualified transferee. Act 52 defines a qualified transferee as a spouse, any lineal descendant (such as a child or grandchild), any sibling or descendant of a sibling (such as a nephew or niece), any ancestor (such as a father, mother, or grandparent) or any ancestor's sibling (such as an aunt or uncle).

2. Whether the transfer consists of a "qualified family-owned business" where the decedent was an owner and/or a manager of the business, or whether the transfer was of merely an interest in a qualified family-owned business. The requirements differ for each.

If the decedent were an owner and/or a manager of the business, the business, as of the date of death, must have: (1) fifty full-time employees or less; (2) a net book value of less than five million dollars; and (3) been in existence for at least five years. The Act does not specify how the Department of Revenue would compute the net book value. Additionally, the Act does not require that the business must have been "family-owned" for the five years before the decedent's death.

If the decedent were not an owner and/or a manager of the business, but merely owned a partial interest in a business, the same restrictions apply as if the decedent were an owner and/or a manager with some additional limitations. First, the business must be wholly owned by a member or members of the decedent's family who meet the definition of qualified transferee. Second, the principal purpose of the business cannot be the management of investments or of income-producing assets that the business owns.

The Act has articulated several other restrictions to discourage abuse of the exemption. If a decedent transferred individually owned property into the business within one year of death, the property so transferred is not exempt from inheritance tax unless that property was transferred to the business for a legitimate business purpose. Perhaps the most stringent requirement is that a qualified transferee must continue to own the qualified family-owned business interest for seven years after the death of the decedent. To ensure compliance, the Department of Revenue requires that the owner of the qualified family-owned business interest certify, on an annual basis for seven years after the decedent's death of death, that a qualified transferee continues to own the qualified family-owned business interest. If the business, within the seven year window, fails to qualify for the exemption, the owner of the business interest must notify the Department of the Revenue within thirty days. The ramifications of failing to qualify and/or comply are severe: if the owner fails to file its certification or keep in compliance, the Department of Revenue will issue a lien for the original inheritance tax as well as accrued interest on the inheritance tax, dating back to when the inheritance tax was due. It also appears that the inheritance tax, and the accrued interest, are the personal obligation of the owner of the business interest.

There are several open questions under Act 52 which forthcoming regulations may address. It is

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CASE SUMMARY FROM THE ORPHANS' COURT LITIGATION COMMITTEE

Jamack Estate v. Reis, 4 Fiduc. Rep. 3d 25 (C.P. Lycom. 2013)

BY ADAM T. GUSDORFF, ESQ. | HECKSCHER, TEILLON, TERRILL & SAGER, P.C.

The Dead Man's Rule is alive and well in Pennsylvania. And, as a recent case from the Lycoming County Court of Common Pleas reminds us, it is as complicated as ever to apply, particularly when the issue involves the propriety of an inter vivos gift.

The Dead Man's Rule, which is stated at 42 Pa. C.S. § 5930, is a statute addressing the threshold ability of a witness to take the stand and is not an evidentiary rule addressing the admissibility of evidence. It is an exception to the general rule that every person is competent to testify. In essence, the Rule provides that surviving parties to a transaction or event who have an interest that is adverse to a decedent may not testify about matters that occurred prior to the decedent's death. The purpose of the Rule is to "prevent the injustice that would result from permitting a surviving party to a transaction to testify favorably to himself and adversely to the interest of the decedent, when the decedent's representative would be hampered in attempting to refute the testimony, or be in no position to refute it, by reason of the decedent's death." *In re Estate of Hall,* 535 A.2d 47, 53 (Pa. 1987). Putting it more bluntly, the Rule exists because the surviving party "could lie … knowing the other party is incapable of contradicting the fallacious testimony." *Punxsutawney Mun. Airport Auth. v. Lellock*, 745 A.2d 666, 670 (Pa. Super. 2000).

Three conditions must be met for a witness to be incompetent to testify: (1) the deceased must have had an interest in the matter at issue, i.e., an interest in the immediate result of the suit; (2) the interest of the witness must be adverse; and (3) a right of the deceased must have passed to a party of record who represents the deceased's interest.

Estate of Rider, 409 A.2d 397, 399 (Pa. 1979); see also *Estate of Hendrickson,* 130 A.2d 143, 146-47 (Pa. 1957). The party challenging competency has the burden to prove that the witness is incompetent under the Rule. *See Rider*, 409 A.2d at 399.

Generally, the third prong – identification of the party of record who represents the decedent's interest – is the easiest to satisfy, as it almost always is the decedent's personal representative, who is defending the estate against a claim or who is attempting to recover assets that properly belonged to the decedent at his or her death. Things get murky, however, when the surviving party to a transaction with the decedent alleges that the property at issue was given to him as an inter vivos gift. In that case, who represents the decedent's interest is difficult to determine, because if the gift is valid, then the personal representative seeking to recover the item actually would be acting contrary to the decedent's interest

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PENNSYLVANIA INHERITANCE TAX EXEMPTION, continued

uncertain whether transfers of family-owned business interests into trusts will qualify for the exemption. It is also unclear whether there will be an aggregation rule if different parts of a business are operating as separate legal entities. Another question is whether estates with businesses not based in Pennsylvania will be able to take advantage of the exemption. The Department of Revenue has not yet issued regulations and these questions remain unanswered.

All in all, this new exemption provides significant tax relief for Pennsylvanians who are qualified transferees and who stand to inherit qualified family-owned business interests. However, many important questions remain unaddressed and the consequences of failing to comply can be severe. Thus, one must proceed with caution until the Department of Revenue issues regulations.

JAMACK ESTATE, continued

on the notion that the decedent wanted the donee to have the item. Accordingly, where the dispute involves an inter vivos gift, the first issue to be determined is who gets the benefit of the Dead Man's Rule, i.e., who represents the decedent's interest and whose interest is adverse to the decedent's interest.

The alleged donee is incompetent unless the gift is prima facie valid. *See Estate of Miller*, 346 A.2d 761 (Pa. 1975). The donee must establish, by clear and convincing evidence, the prima facie validity of the gift by independent testimony and evidence of donative intent and delivery. *See In re Estate of Petro*, 694 A.2d 627 (Pa. Super. 1997); *see also Citrino Estate*, 29 Fiduc. Rep. 2d 498 (O.C. Phila. 2009). If the evidence indicates that, at the decedent's death, the disputed property belonged to the decedent, the "donee" is incompetent. *See Zigmantanis v. Zigmantanis*, 797 A.2d 990 (Pa. Super. 2002); *Petro*, supra. However, if the donee makes his prima facie case, he represents the decedent's interest and is competent to testify, and the person challenging the gift is barred. *See, e.g., Long v. Long,* 65 A.2d 683 (Pa. 1949).

In *Jamack Estate v. Reis,* 4 Fiduc. Rep. 3d 25 (C.P. Lycom. 2013), the personal representative of the decedent (William Jamack) initiated a civil action to recover items of tangible personal property from a woman (Denise Reis) who had lived with and had a relationship with the decedent prior to his death. One of the items was a Rolex watch, which Reis claimed had been given to her son by Jamack. The personal representative filed a motion to preclude Reis from testifying about the alleged gift of the Rolex.

The court recited the three requirements for the Dead Man's Rule to apply and relied on *Hendrickson*, supra, in its analysis of the applicability of the Rule. In *Hendrickson*, the decedent's daughter asserted ownership of a ring that had been purchased by the decedent (her father) and was in the decedent's possession at his death. Under those facts, the Supreme Court found the daughter incompetent to testify. The *Jamack* court found *Hendrickson* to be "controlling" and determined that Reis's son (the alleged donee) was incompetent to testify under the Dead Man's Rule. *Jamack*, 4 Fiduc. Rep. at 28. The court apparently did not find it significant that in this case, the alleged donee was in possession of the Rolex, id. at 28, whereas in *Hendrickson*, the decedent was in possession of the ring at his death. The court also did not refer to the authority cited above for the proposition that, if the son could establish a valid gift by clear and convincing evidence from independent testimony, then he would be competent to testify.

Regardless, the court then proceeded to analyze whether Reis herself was competent to testify about the alleged gift. For this analysis, the court focused on the second requirement of the Rule – that the witness's interest must be adverse to the decedent's interest. In the case of the son, this prong was clear – since the son would gain or lose by the outcome of the case (i.e., he gets the watch or he does not), his interest is adverse. Reis, however, would not get anything or lose anything based on the outcome. In other words, while her testimony would be adverse to decedent, her interest was not. The court relied on a series of cases that found that "a child's adverse interest does not render a parent's or a relative's testimony incompetent." *Id*. at 28. For these reasons, the court concluded that Reis was competent to testify about the alleged gift and that her "assumed partiality toward her son's interest is a factor to be considered by the trier of fact to determine credibility." *Id*. at 28-29.

Certainly, the court made the correct ruling with respect to Reis, which could be her son's saving grace, as it gives him the opportunity to prove the gift through independent (albeit possibly biased) testimony. Of course, Reis's testimony could be supported by relevant documents or by testimony from other third-party witnesses who have knowledge of the gift. However, while the court also made a correct initial determination with respect to the son's incompetence to testify, the absolute nature of its ruling indicates that it might have failed to recognize that the son

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JAMACK ESTATE, continued

could ultimately be the "decedent's representative" who could represent the decedent's interest with respect to the purported inter vivos gift of the Rolex watch and thus be competent to testify as to all matters.

*   *   *   *   *

The January 2014 advance sheets of the Fiduciary Reporter also feature a case in which the U.S. District Court for the Eastern District of Pennsylvania applied the Dead Man's Rule. See *Jackson Nat'l Life Ins. v. John Heyser et al.*, 4 Fiduc. Rep. 3d 29 (E.D. Pa. 2013) (finding named beneficiaries of an annuity contract incompetent to testify). The case provides an important reminder for federal court practitioners that, even though the Federal Rules of Evidence do not recognize the Dead Man's Rule, the Rule will nonetheless apply where there is diversity jurisdiction and Pennsylvania substantive law will determine the competence of a witness. See *Jackson*, 4 Fiduc. Rep. 3d at 32 (citing Fed. R. Evid. 601, which provides: "Every person is competent to be a witness unless these rules provide otherwise. But in a civil case, state law governs the witness's competency regarding a claim or defense for which state law supplies the rule of decision.").

ETHICS COLUMN

BY PAUL C. HEINTZ, ESQ. | OBERMAYER, REBMANN, MAXWELL & HIPPEL LLP

May a lawyer use coupons or Groupon Deal-of-the-Day programs to market his or her practice of preparing Wills and Trusts?

A lawyer's use of coupons or conventional media advertising services to sell discount coupons to be used to pay for his or her services does not, per se, constitute a violation of the Rules of Professional conduct. Of course, a lawyer must be certain that the exact scope of service and the limitations on his or her time devoted to the assignment are made clear. Furthermore, the lawyer probably should place a cap on the coupons to be certain he or she can promptly and diligently provide the agreed-upon services to all of the coupon purchasers in view of the possible increase in contacts by potential clients.

However, the lawyer's use of marketing organization websites, such as Groupon Deal-of-the-Day programs, has been deemed to violate the Rules of Professional Conduct in Pennsylvania. See Pennsylvania Bar Association Advisory Opinion 2011-27 (2011). The primary concern is that Groupon collects the entire amount paid by the prospective client and remits the balance to the lawyer. That has been deemed to be fee-sharing that violates Rule 5.4. Other concerns mentioned by the PBA Committee include the inability of the lawyer to pre-screen for conflicts of interest (Rule 1.7) and the probability of "false or misleading communications about the lawyer's services" by improperly or inadequately characterizing the services to be provided which violates Rules 7.1 and 7.2. For example, purchasers may not realize that the "simple Will" contracted for may not be a true simple Will, and the services needed could well expand beyond that anticipated by the prospective client.

A recent opinion issued by the ABA's Committee on Ethics and Professional Responsibility notes that some jurisdictions have approved prepaid deals and opines that they may be properly structured. However, it adds that there are "... a number of different issues associated with prepaid deals and [it] is less certain that prepaid deals can be structured to comply with all ethical and professional obligations of the Model Rules." ABA Formal Opinion 2013-465.

WHAT WOULD YOU LIKE TO SEE IN FUTURE ETHICS COLUMNS?

Send your questions and ideas to:

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TAX UPDATE

BY MARGERY J. SCHNEIDER, ESQ. | ROSENN JENKINS & GREENWALD, LLP

FEDERAL ESTATE TAX

Retained Interests under IRC Section 2036(a)

Estate of Trombetta v. Commissioner, T.C. Memo. 2013-234 (October 21, 2013)

The Tax Court held that a taxpayer's lifetime transfers of real property to two trusts were transfers with a retained interest and thus includible in the grantor's estate. In 1993, the decedent, a California resident, transferred several properties to an annuity trust of which she was the sole grantor and the sole beneficiary. As co-trustee of the trust, she possessed 50% of the voting rights, and several her children split the other 50% as co-trustees. The annuity was structured with a term of 180 months but the decedent had the right to reduce the term at any time. At the termination of the trust or the decedent's death, whichever was later, the property would go to the decedent's issue. The decedent died during the term of the annuities. In 2006, the decedent reduced the term of the annuity trust so that it would terminate on July 31, 2006. She died on September 2006. Her estate tax return did not include these properties in the value of her gross estate.

The court rejected the estate's argument that the transfers to the annuity trust were part of a bona fide sale for full and adequate consideration and held that the value of the transferred properties was includible in the decedent's estate under IRC § 2036(a). It found that the decedent as grantor retained an interest in the properties and did not part with all title, possession and enjoyment in them. The Court considered the following factors:

(a) The grantor retained dominant trust voting rights. The decedent made all decisions with respect to the properties and the co-trustees generally acted on her recommendation. In addition, she retained sole signatory authority with respect to the disposition of the properties.

(b) The co-trustees were empowered to distribute income in excess of the scheduled annuity payments to the grantor, which allowed her to maintain the same enjoyment of the properties and their income stream as she had before the properties were transferred to the trust;

(c) Since the co-trustees admitted that the sole purpose in transferring the properties to the trust was to minimize taxes, the trust lacked a legitimate business purpose.

(d) A portion of the transfers to the trust consisted of a gift from the decedent because the present value of the payments did not equal the value of the transferred property.

(e) The decedent, as both sole grantor and sole beneficiary, stood on both sides of the transaction.

Also, in ruling that the transaction could not be considered a bona fide sale for an annuity, the Court cited Ray, 762 F2d at 1363: a sale for an annuity was not valid when "(1) the property the taxpayers transferred to the trust was, in effect, the only source for their "annuity" payments; (2) since the trust's income was designed to equal the annual payments to the taxpayers, the "annuity" payments would not be paid from the trust corpus; and (3) the trust corpus would be available for "ultimate distribution to the trust beneficiaries." It stated that a proper sale in exchange for an annuity took place where "the parties structured the transaction as an annuity obligation, the amount of the annuity did not bear a mathematical relationship to the trust income, the transferor did not control the property transferred, and the trust corpus was used to pay the annuity rather than simply providing for annuity payments as a conduit for the trust income."

Further, the Court declined to apply the "legitimate and significant nontax reasons" standard that is often applied to determine whether there is a bona fide sale when

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properties are transferred to a family limited partnership. Here, they stated that a transfer to a grantor trust is not comparable to a transfer to a family limited partnership, especially when the grantor is the only person with a present interest in the trust.

The Court also held that the value of the transferred properties was includible in the decedent's gross estate under IRC § 2035 because in reducing the annuity trust term she relinquished certain rights with respect to the properties within three years of her death.

Concerning the separate issue of the estate inclusion of the value of a personal residence which the decedent had transferred into a QPRT in 1993, the Court ruled that since the decedent had the right to reside in the property and actually did reside in the property until her death, the entire value of the property was includible in her estate under IRC §2036.

Special-Use Valuation of Qualified Real Property

Van Alen v. Commissioner, T.C. Memo 2013-235 (October 21, 2013)

This case concerns the capital gain implications at the time of the later sale of property when a special use valuation under IRC § 2032A is employed for that property at the time of death.

A brother and sister inherited part of a large cattle ranch from their father in 1994. Their stepmother valued their interest, which was held in a trust, at under $100,000 when she prepared the estate tax return. The valuation was based on the actual use of the ranch at the time of death under IRC § 2032A, rather than on its hypothetical highest and best use. Ten years after settling its estate tax liability, the siblings sold a conservation easement on the ranch for more than $900,000, thereby creating a large capital gain that passed through to them. They protested the assessment of this capital gain by the IRS because, as they argued, the estate had greatly understated the value of their interest by the IRC § 2032A election.

The Tax Court found in favor of the IRS. Citing the doctrine of duty of consistency, it held that the Trust's inherited basis in its ranch interest was its IRC § 2032A value, not its fair market value, because the estate had intentionally chosen to use the IRC § 2032A valuation method and the siblings, as qualified heirs, affirmatively consented to it. The Court noted that the siblings had benefited from the date of death valuation method because they inherited the majority of the taxable estate.

QTIP Trust

Private Letter Ruling 201345006 (November 8, 2013)

The IRS disregarded the QTIP election under IRC § 2056(b)(7) with respect to a marital trust when the election to treat assets of a marital trust as QTIP property was not necessary to reduce the estate tax liability to zero because no estate tax would have been imposed on the assets even if the QTIP election had not been made. In making this ruling, the IRS applied Rev. Proc. 2001-38, which provides that a QTIP election is considered null and void when the election is not necessary to reduce the estate tax liability to zero. The Letter Ruling stated that the QTIP property election would also be considered a nullity for federal gift and GST tax purposes.

2014 Estate Tax Exclusion amount

Estates of decedents who die during 2014 have a basic exclusion amount of $5,340,000, increased from the $5,250,000 exemption for estates of decedents who died in 2013.

Refund of Attorneys' Fees and Costs

Estate of Mary Ellen Johnson v. U.S. Civil Action No. 11-10148-RWZ (October 18, 2013)

The U.S. District Court for the District of Massachusetts denied the request of an estate for the refund of attorneys' fees and costs after seeking a refund of federal estate taxes. Under IRC Section 7430(c)(4)(A)(i)(I)-(II), a taxpayer may recover attorneys' fees and costs if it "substantially prevailed" on either the amount in controversy or the

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most significant issue or set of issues presented in the underlying action.

The court held that the estate did not "substantially prevail" in the underlying issues because, although the estate won on two of the three underlying issues, these issues were peripheral to the third and principal issue in the case, which was the inclusion of the disputed assets in the estate. The court also found that, although the amount of the tax refund awarded to the estate was about 51 percent of the total tax deficiency, this amount did not necessarily rise to the level of "substantially prevailing" on the amount in controversy.

Moreover, the court stated that, even it the estate was found to "substantially prevail" on the amount in controversy, it was not entitled to attorneys' fees and costs because the government's position was "substantially justified" under IRC Section 7430(c)(4)(B)(i), as indicated by the fact that the estate conceded that the transferred assets were includible in the estate and agreed to settle the case.

FEDERAL GIFT TAX

IRS Chief Counsel Advisory 201330033 (July 26, 2013)

The IRS Chief Counsel's office ruled that transfers of stock from a decedent to the grantor trusts shortly before the decedent's death in exchange for self-cancelling installment notes (SCINs) constituted a taxable gift when the notes was accepted with no expectation of repayment and no intention of enforcing the debt. The notes were not considered to be bona fide because of the poor health and substantial assets of the decedent and the interest-only nature of the notes.

2013-2014 DEPARTMENT OF THE TREASURY PRIORITY GUIDANCE PLAN

First Quarter Update (November 20, 2013)

The 2013–2014 Priority Guidance Plan contains projects that are priorities for allocation of IRS resources during the twelve-month period from July 2013 through June 2014 (the plan year). Item #5 below is new to the First Quarter Update.

1. Final regulations under §67 regarding miscellaneous itemized deductions of a trust or estate. Proposed regulations were published on September 7, 2011.

2. Guidance concerning adjustments to sample charitable remainder trust forms under §664.

3. Guidance concerning private trust companies under §§671, 2036, 2038, 2041,2042, 2511, and 2601.

4. Regulations under §1014 regarding uniform basis of charitable remainder trusts.

5. Revenue Procedure under §2010(c) regarding the validity of a QTIP election on anestate tax return filed only to elect portability.

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

7. Guidance under §2053 regarding personal guarantees and the application of present value concepts in determining the deductible amount of expenses and claims against the estate.

8. Regulations under §2642 regarding the allocation of GST exemption to a pour-over trust at the end of an ETIP.

9. Final regulations under §2642(g) regarding extensions of time to make allocations of the generation-skipping transfer tax exemption. Proposed regulations were published on April 17, 2008.

10. Regulations under §2704 regarding restrictions on the liquidation of an interest in certain corporations and partnerships.

11. Guidance under §2801 regarding the tax imposed on U.S. citizens and residents who receive gifts or bequests from certain expatriates.

PRACTICE POINT

BY BERNICE J. KOPLIN. ESQ. | SCHACHTEL, GERSTLEY, LEVINE & KOPLIN, P.C.

This practice point addresses a strategy regarding notice of the filing of a complaint in the Orphans Court utilized by some attorneys, for which the reader should be aware. During the efiling process in the Orphans Court Division, the question is asked (it is the first question on page 3) whether notice is required. There are 3 responses from which the filer may choose: no, yes (in which case a copy of notice is required to be attached to the pleading and the date of notice provided, and "Yes. All joinders are attached." Regardless of the response, the filing is electronically sent to all parties and interested persons (and oftentimes to attorneys no longer on the matter).

As part of the efiling procedure, an Orphans Court Division cover sheet is produced and becomes part of the filing. Some attorneys have been answering the notice question that no notice is required, even when it is required, in order to facilitate their filing. Although a cover sheet is produced and the filing sent electronically to those listed, there is typically no notice letter attached to these filings. What is significant about this is that the notice letter is the Orphans Court Division's equivalent of the Trial Division's Notice to Defend, without which a filing in the Trial Division would be rejected, and without which service of the complaint is invalid.

Attorneys who receive notice of an efiled document should nevertheless check for the notice letter that is required to be attached, as service is invalid unless the notice letter is attached to the pleading. Mere receipt of the pleading, whether electroncially or otherwise is insufficient; and thus the recipient should not inadvertently waive proper notice and service.

Special thanks is due to Adam Gusdorff, Esquire for bring this situation to my attention.

Please note that readers are encouraged to send their questions or ideas for consideration in future columns to Bernice J. Koplin at bjkoplin@sglk.com.

PROBATE AND TRUST LAW SECTION COMMITTEE INFORMATION

Business Planning Committee. The Business Planning Committee meets quarterly to discuss topics of interest to trusts and estates lawyers who also provide business counsel to closely held businesses, on subjects including choice of entity and ownership of businesses, business succession planning, asset protection planning and buy-sell agreements. Through panel discussions and outside speakers, the Committee seeks to increase the expertise of trusts and estates lawyers in dealing with a broad range of issues and opportunities faced by business owners. For more information, contact co-chairs Dennis Reardon at DReardon@DReardonLaw.com or Bob Louis at rlouis@saul.com.

Diversity Committee. The Diversity Committee works to encourage participation in the activities of the Section by a diverse group of attorneys representing the entire legal community. It promotes inclusion of lawyers of every race, ethnicity, gender, age, national origin, or sexual orientation in the Section's programs and in the work of its committees and leadership. The Diversity Committee holds meetings on an ad hoc basis. For information, please contact committee chair Gordon Wase at gordon.wase@verizon.net.

Education Committee. The Education Committee meets during the 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 provide a two-hour presentation at the quarterly meetings. After the presentations are completed, the Committee reviews the evaluations that are generated from program attendees and utilizes those

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evaluations to improve upon future programs. The Committee welcomes suggestions for future program topics, and any interested Section members are encouraged to join the Committee by contacting Committee Chair Laura Stegossi at 215.972.7918 or lstegossi@wglaw.com.

Elder Law Committee. The mission of the Elder Law Committee is to further the knowledge and practices of members of the legal community having an interest in problems relating to the aging by developing educational programs and the information necessary to stay abreast in this growing and ever changing area of law. Our goal also is to study, review and make recommendations concerning legislation affecting the elder community. We further wish to serve the public generally by developing literature that will provide information about legal issues faced by the elder community and their caregivers. Meetings are generally held the fourth Thursday of the month at the Bar Association from 1-2:30 p.m. Lunch is available if reserved and there is a guest speaker. All Philadelphia Bar Association Members are welcome. Our next meeting is on October 24, 2013 at noon. For information, please contact committee chair Linda M. Hee at lhee@sgtmlaw.com.

Legislative Committee. The Legislative Committee monitors and provides comments on pending and proposed legislation in the areas relating to estate planning, and estate and trust administration. When appropriate, the Committee drafts proposed legislation on behalf of the Section. Currently, the Committee has two active subcommittees involved with proposed legislation. One subcommittee is in the process of receiving comments on a draft of Directed Trustee legislation prepared by members of the subcommittee. The second subcommittee is researching and analyzing the preparation of a proposed legislation regarding fiduciary authority over digital assets. Meetings are generally held the third Wednesday of the month at 4:00 p.m. at Pepper Hamilton at 18th & Arch Streets. Michael Stein is the Chair of the Committee. Michael may be contacted at PNC Bank, 1600 Market Street, Philadelphia, PA 19103, 215-585-8027 or michael.r.stein@pnc.com.

Orphans' Court Committee. The Orphans' Court Litigation Committee meets monthly on the second Tuesday of each month except for June, July, August, and December. The meetings begin at 8:30 am in the morning at One Liberty Place in Center City. An agenda for each meeting usually involves a presentation and a discussion of a recent Orphans' Court case as well as issues and fact patterns that Orphans' Court litigators will frequently encounter. Following the presentation, a lively discussion among the committee members addresses the designated topic, and how the committee members have dealt with the issues and fact patterns in practice. For more information about this committee, please contact Committee Chair, Timothy J. Holman, at (610)-518-4909, or at tholman@smithkanelaw.com.

Publications Committee. The purpose of the Publications Committee is to further the knowledge and practices of members of the legal community through the publication of articles in this Probate and Trust Law Section Newsletter that are current, relevant and informative. The Newsletter generally is published three times per year. The Publications Committee will hold its next two meetings at the offices of Ballard Spahr, LLP, 1735 Market Street, at 8:30 a.m. on June 26th and November 19th. For information, please contact committee chair, Heike K. Sullivan at sullivanh@ballardspahr.com.

Rules and Practice Committee. The Rules and Practice Committee drafts local rules and the forms to accompany them, which are suggested to the Committee by the Judges of the Orphans Court Division of the Court of Common Pleas, local practitioners, or which the Committee determines are needed in connection with practice before the Orphans Court Division or the Office of the Register of Wills. Over the past years this Committee has published the Green Book, Blue Book and Red Book and updated them as needed. It has reviewed and commented upon the new proposed statewide Orphans Court Rules, reviewed the first draft of the Guardianship Manual, and drafted rules and forms for local use which also served as guides for the statewide forms now in effect. This committee also addresses procedural problems which

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COMMITTEE INFORMATION, continued

come to its attention for the benefit of the Court and practitioners, and generally resolves such problems. For more information, please contact committee chair Bernice Koplin at bjkoplin@sglk.com.

Tax Committee. The Tax Committee meets monthly on the 4th Tuesday of each month, except for July, August and December. The meetings are typically at 8:15 in the morning in Center City. During the meetings, a written summary of pertinent recent developments in the tax law is distributed and reviewed with a short oral presentation focusing on highlights, and then, at most meetings, a speaker addresses a predetermined tax related topic. The meetings are frequently interactive and periodically include ad hoc discussions on various topics of current interest to committee members related to tax issues. Traditionally, certain monthly meetings have been reserved for specific purposes: January for determining the agenda for the year and discussing The Heckerling Institute programming, October for representatives from the PA Department of Revenue, and November for representatives from the IRS (although none have been available from the IRS in recent years). For more information about this Committee, please contact Committee Chair, Rebecca Rosenberger Smolen, at (610) 624-3391 or rebecca@balalaw.com; or Committee Secretary, Marguerite Weese, at (215) 419-6561 or mweese@wilmingtontrust.com.

Philadelphia Estate Planning Council

PEPC

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

February Luncheon Program
February 18, 2014
11:45 a.m. - 1:45 p.m.
The Union League
140 S. Broad Street, Philadelphia, PA
Topic: "Portability: The Silent Partner of Estate Planning"
Speaker: Barbara Sloan

March Luncheon Program
March 18, 2014
11:45 a.m. - 1:45 p.m.
The Union League
140 S. Broad Street, Philadelphia, PA
Topic: "Ethical Issues of Multi-Disciplinary Teams"
Speaker: Bruce Stone

2014 Annual Meeting
May 6, 2014
4:30 9.m. - 9:00 p.m.
University of Pennsylvania Museum of Archaeology and Anthropology
3260 South Street, Philadelphia, PA
Speaker: Professor Samuel A. Donaldson

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