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Report of the Chair

By ROBERT H. LOUIS
SAUL EWING LLP

We live in an era of great uncertainty as to the tax laws that affect much of our planning work, and in a time when the need for wealth and retirement planning expertise has never been greater. There is a demand for the services and skills we can offer to clients that should continue for many years. I hope you will think of the Probate and Trust Law Section as a valuable partner to you in meeting these challenges and opportunities in your practice.

Many people assist in the work of the Section, in planning educational and social programs and in carrying out the specialized activities of our various committees. Working on a committee is a great way to learn and to become known in the community. Please contact me (rlouis@saul.com) or a committee chair if you are interested.

As a means of providing greater interaction among Section members, we have established a Linkedin (www.linkedin.com) account for the Section. Consider joining that group and exchanging information and questions.

We are committed to promoting the widest possible involvement in our Section and practice area, for all sizes of firms and all backgrounds of lawyers. If there are additional activities that you believe will promote greater diversity among us, I hope you will give me your thoughts and suggestions.

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IS THIS THE END OF WILLIAMSON?

By LISA M. LASSOFF
DILWORTH PAXSON LLP

On November 23, 2011 the Pennsylvania Supreme Court in *Estate of Anna E. Fridenberg, Deceased v. Commonwealth of Pennsylvania,* No. 32 EAP 2010, overruled over sixty years of case law governing fiduciary compensation. The Court determined that a trustee could receive principal compensation from a testamentary trust created prior to 1945 when the trustee had previously received principal compensation as executor of the testator's estate.

In *Fridenberg*, Anna Fridenberg died in 1940 leaving a Will created in 1938 which provided that her residuary estate was to be held in trust to pay the net income therefrom to five named individuals. The Jewish Hospital Association of Philadelphia was to receive the remainder of the net income "for the perpetual upkeep, maintenance and support of the Fridenberg Memorial Surgical Building." Ms. Fridenberg had appointed an individual trustee and Fidelity-Philadelphia Trust Company (which became Wachovia and is now Wells Fargo) to serve as her co-executors and co-trustees under her Will. After the individual trustee's death, Wachovia filed a third account for the trust from the close of the second accounting in 1978 to March 16, 2005. In the third accounting Wachovia requested commissions out of principal for the individual trustee and itself. The Attorney General, on behalf of the Jewish Hospital Association of Philadelphia, objected to the principal commissions. It claimed that the law in effect at the time the trust was established prevented parties who served as both executors and trustees under a will from receiving more than one commission from principal.

The Philadelphia County Orphans' Court sustained the Attorney General's objection, reasoning that the law at the time Ms. Fridenberg created the trust prohibited more than one commission from principal, despite subsequent changes in the law sixty years later that allowed more than one principal commission. Wachovia appealed the decision and the Superior Court reversed. The Superior Court determined that the legislative enactments over the past sixty years, allowing more than one principal commission for previously established trusts, were constitutionally valid. The Attorney General appealed to the Pennsylvania Supreme Court, which reviewed de novo the issue of whether testamentary trustees who were paid a principal commission for executor services prior to 1945 could receive an additional commission for ordinary services performed as trustee.

Section 45 of the Fiduciaries Act of June 7, 1917, No. 193, § 45, 1917 P.L. 447, 511 ("1917 Act") was the law in effect at the time the trust was established in 1938. It barred more than one principal commission for a person serving as both executor and trustee. However, the Act of April 10, 1945, No. 90, § 1, 1945 P.L. 189, 189-90 ("1945 Act"), repealed the 1917 Act's bar against a trustee receiving more than one principal commission. In *In re Williamson's Estate*, 82 A.2d 49 (Pa. 1951), the Pennsylvania Supreme Court discussed the effect of the 1945 Act on trusts created prior to 1945. In *Williamson's Estate*, the testatrix appointed a corporate fiduciary as both a co-executor and co-trustee in her will. The testatrix died in 1930. The corporate fiduciary received a principal commission for its executor services and sought a principal commission for its trustee services after the death of a trust beneficiary. The Court acknowledged that fiduciaries were entitled to fair and just compensation, but at the same time weighed the effects of two world wars and the Great Depression on trust beneficiaries. The Pennsylvania Supreme Court at that time held that applying the 1945 Act retroactively would be unconstitutional under the 14th Amendment and that it was the responsibility of the Legislature, and not the Court, to change the current law.

In response to *Williamson*, there were numerous subsequent enactments by the Legislature to permit additional compensation for trustees. Under Section 2 of the Act of May 1, 1953, No. 10, 1953 P.L. 190, 191 ("1953 Act"), the Legislature modified the law to provide that multiple commissions were acceptable. The 1953 Act applied retroactively to all services previously rendered by the fiduciary. The Legislature again amended the law on trustee payments when it enacted the Probate, Estates and Fiduciaries (PEF) Code in 1972 ("1972 Act"). Section 7185 of the PEF Code allowed more than one commission from principal and applied retroactively to any trust created before, on, or after February 18, 1982. The Legislature once more amended the law in 2006, repealing Chapter 71 from the PEF Code and adding Chapter 77, the Uniform Trust Act ("UTA"), 20 Pa.C.S. § 7701 et

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seq. Section 7768(c)(3) of the UTA provides that the fact that the trustee of a testamentary trust also acted as the settlor's personal representative and was or might have been compensated for services as personal representative from the principal of the settlor's estate will not prevent a trustee from receiving compensation from the income or principal of the trust. The Joint State Government Commission's comment to § 7768 further provides that "[s]ubsection (c)(3) repeals the contrary rule of *In re Williamson's Estate*, 82 A.2d 49 (Pa. 1951), as to the few trusts that might still be affected by the rule." Joint State Gov't Comm'n, Report of the Advisory Committee on Decedents' Estates Laws, 82 (Apr. 2005).

In arguing *Fridenberg* before the Pennsylvania Supreme Court, the Attorney General relied on the doctrine of stare decisis, which provides that a decision reached in one case should be applied to those which follow if the facts are substantially the same even though the parties may be different. The Attorney General claimed that retroactive application of Williamson would reduce the amount of trust principal and thereby deprive the beneficiaries of their property. It further contended that retroactive application would violate the Contracts Clause under the United States Constitution as the beneficiaries only expected one commission from principal to be paid to the trustee. In response, Wachovia noted that it was seeking compensation for the period from 1998 to 2005 when PEF Code § 7185 was in effect, which provided for principal compensation for trusts created before February 18, 1982. It also claimed that the Attorney General failed to recognize the presumption that legislative enactments are constitutional.

The Pennsylvania Supreme Court reasoned that *Williamson* only analyzed the 1945 Act and not the 1972 Act at issue in *Fridenberg*. It further acknowledged it would not apply stare decisis when the reason for the precedent no longer exists. It recognized that since the *Williamson* case trustees have become more active in managing investments and have added responsibilities in managing investments with more risk. The Court noted the Legislature acknowledged the change in trustee responsibilities since 1940 with its subsequent enactments allowing more than one commission from principal. The Court also concluded that since the compensation terms were not specified in the Fridenberg trust, there was no contract and therefore no violation of the Contracts Clause.

At the time that the Pennsylvania Supreme Court rendered its decision, I was representing a trustee of a pre-1945 testamentary trust, which had previously received principal compensation as executor of the testator's estate. The trustee was in the process of terminating and distributing the testamentary trust as the last life tenant had died. In light of the Pennsylvania Supreme Court decision, the trustee was faced with the decision of whether to now charge a principal commission and whether the starting period would be the date when the trust was funded over seven decades ago. In my case, the trustee claimed a principal compensation termination fee in light of *Fridenberg,* which was approved by the Orphans' Court. It does appear that *Fridenberg* was in fact the end of *Williamson*.

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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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The Final Regs are Out: Are your Returns Timely-Mailed and Timely-Filed?

By AMY C. QUIGG

On August 23, 2011, the IRS issued final regulations §301.7502.1 which govern establishing evidence of delivery to the IRS. The regulations provide that proper use of registered or certified mail or a private delivery service under criteria to be established by the IRS, will provide prima facie evidence of delivery.

Section 7502(c)(1) states that: "For purposes of this section, if any return, claim, statement, or other document, or payment, is sent by United States registered mail –

> (A) such registration shall be prima facie evidence that the return, claim, statement, or other document was delivered to the agency, officer or office to which it was addressed; and
> (B) the date of registration shall be deemed the postmark date."

The Code further extends the same treatment to certified mail under §7502(c)(2). In addition, under §7502(f), the IRS has the power to designate private delivery services to be treated in the same manner as certified mail.

The current list of designated private delivery services ("PDS") are:

1. DHL Express (DHL): DHL Same Day Service; DHL Next Day 10:30 A.M.; DHL Next Day 12:00 P.M.; DHL Next Day 3:00 P.M.; and DHL 2nd Day Service;

2. Federal Express (FedEx): FedEx Priority Overnight; FedEx Standard Overnight; FedEx 2 Day; FedEx International Priority; and FedEx International First; and

3. United Parcel Service (UPS): UPS Next Day Air; UPS Next Day Air Saver; UPS 2nd Day Air; UPS 2nd Day Air A.M.; UPS Worldwide Express Plus; and UPS Worldwide Express.

If you use a delivery service that is not on the above list you are not afforded the protection of §7502(c)(1)(A). Prior to the issuing of the final regulations, the federal courts were split over the issue of whether §7502(c) established the exclusive means to establish prima facie evidence of delivery.

The final regulations, Treas. Reg. §301.7502.1, provide that (1) direct proof of actual delivery, (2) proof of proper use of registered or certified mail, or (3) proof of proper use of a PDS, are the sole means to establish prima facie evidence of delivery of documents that have a filing deadline prescribed.

The effective date of the final regulations is August 23, 2011 and applies retroactively to any payment or document mailed and delivered in accordance with §7502 in an envelope bearing a postmark dated after September 21, 2004.

A Variety of Pro Bono Opportunities Available with Philadelphia VIP

By KELLY J. GASTLEY
SUPERVISING ATTORNEY, PHILADELPHIA VIP

Philadelphia VIP serves as the hub of pro bono civil legal services in Philadelphia. VIP receives referrals from other legal services agencies and is generally the agency of last resort for low-income Philadelphians. The average VIP client is in a family of four and makes about $1,900 per month. Without the legal representation provided by VIP volunteer attorneys, VIP clients would not be able to obtain free representation, or afford to pay for representation, to resolve their pressing legal issue. As a result, VIP volunteer attorneys ensure that low-income Philadelphians have access to the justice system for their most basic and vital legal needs – maintaining their income, family stability, housing, and community.

VIP is in need of volunteer attorneys for a few types of cases particularly well suited to members of the Probate and Trust Law Section. VIP has many clients who are living in homes they have inherited from a deceased relative but to which they do not have legal title. Without title, these clients cannot apply for repair grants or loans in order to restore their homes to a minimally habitable condition. They also cannot arrange payment plans to pay delinquent real estate taxes, water and sewer bills, and mortgage payments. As these delinquent charges begin to accumulate, these individuals may eventually face foreclosures and Sheriff's sales of their properties, leaving their families without homes and without the only assets that could save them from sinking deeper into poverty. Volunteer attorneys are needed to probate the deceased relative's estate or file a petition in Orphans' Court (which rarely requires any court appearances) to transfer title of the home into the client's name.

VIP also has many clients who are seeking uncontested guardianship of a family member. Often, the client needs to obtain guardianship of a disabled adult child in order to access or stay in public housing, because the Philadelphia Housing Authority requires the adult child to sign the lease. In other cases, the client is seeking guardianship of an elderly parent who needs someone to make medical and legal decisions on his or her behalf. Volunteer attorneys are needed to assist clients in filing for guardianship, so that the most basic needs of the incapacitated persons, particularly as to housing and medical decisions, can be met.

Lastly, VIP clients often need assistance with estate planning documents. Clients who own real property need powers of attorney and wills to ensure that their homes are properly maintained and ultimately passed onto their loved ones, thus preventing deterioration of their homes and further title problems in the future. Other clients, particularly those in declining health, need health care powers of attorney and advance health care directives to ensure that decisions as to their health care are properly made.

VIP is in need of volunteer attorneys to continue to serve these clients, both to represent clients and to serve as mentors to volunteer attorneys who are new to this area of practice. In 2011 alone, VIP matched nearly 700 clients to volunteer attorneys – but unfortunately, VIP was not able to provide legal representation to many of the clients who requested it. With the support of the Probate and Trust Law Section, we can ensure that the basic legal needs of VIP clients are met.

VIP is also launching an exciting Adopt-a-Block project, whereby volunteer attorneys represent clients in a discrete community who are facing title issues. VIP is collaborating with partners in the community to ensure that we can build sustained relationships with clients who need assistance, without requiring volunteer attorneys to travel to the community. The impact of this volunteer opportunity will stretch beyond individual representation and allow volunteer attorneys to directly improve the condition of a particular block of homes. VIP is currently seeking a firm or other group of attorneys who will partner in this innovative collaboration.

If you are able to volunteer in any capacity, please contact Kelly J. Gastley, Supervising Attorney at VIP, at (215) 523-9566 or kgastley@phillyvip.org. We look forward to working with many of you in the future.

"But is it Authentic?"

By DAVID WEISS
FREEMAN'S

The 'art world' at large, including its many players -'runners' or 'pickers;' estate sale agents; art advisors; auction houses; museum curators/directors/associates; art critics/writers/professors; art dealers and general aesthetes - is, in oversimplified terms, thought of as comprising two larger spheres of activity: the academic and the commercial.

The art academician is often perceived by the art dealer as fussy and fanatical, ensconced in a proverbial ivory tower, wearing white gloves so as to ensure that the objets de art for which they are custodians are not harmed. It is said that the academician methodically studies and analyzes every centimeter of these objects without regard for, and insulated from, any time constraints. Conversely, the art dealer is often viewed by the art academician as a philistine concerned solely with the commodification of art and antiques – the buying and selling for profit. It comes as no surprise that many art dealers cannot readily envision making a career transition to museum director, as the often frenetic pace and unpredictable nature of dealing offers a sort of addictive buzz unmatched by the more 9 to 5ish, steady, predictable quality of museum work. The successful transition from high profile gallerist to equally high profile museum director is not without precedent, with the most well-known case being Jeffrey Deitch's move from New York art dealer to the director of a major museum - The Los Angeles Museum of Contemporary Art. The opposite career transition – from director of another major museum – the Kimbell Art Museum, Fort Worth – to both gallerist, and then head of fine arts for an auction house – Heritage, Dallas, was made by the late Edmund Pillsbury.

Misconceptions and the Deitch and Pillsbury examples aside, there is, in truth, a great deal of common ground between the art scholar and art dealer: an inherent appreciation for and enjoyment in handling beautiful objects; and a symbiotic relationship in which the dealer is often reliant upon the judgment of the scholar, and the scholar – particularly those with museum affiliations – not infrequently turning to the dealer to source rare and important material to fill the walls and cases of their hallowed public institutions. Arguably the number one concern of both the art dealer and art scholar is this: is an object 'right' – which is to say, authentic, genuine, the real deal?

Where is the proof that an art dealer is concerned about authenticity? A visit to any of the high profile art galleries in major cities, or to national/international art/antiques fairs (this author has just returned from the renowned TEFAF art/antiques fair in Maastricht, Holland) during which exceptional objects are on offer from many of the world's most notable dealers reveals the interdependent bond between the worlds of art commodification and connoisseurship. A work that is not genuine is not (knowingly) offered by a dealer, as all such works are vetted in advance of major art fairs. The assurance that a work is deemed to be genuine is provided not only by the knowledge and visual acumen of the dealer, but often confirmed by an expert for that particular artist/field/genre. Further, most of the modern day catalogues produced by major art galleries and dealers in conjunction with important exhibitions are themselves well written and researched publications that advance knowledge about a specific artist/field/genre and are, in their own right, important additions to the libraries of the art cognoscenti.

Where is the proof that an art scholar/museum curator is concerned about authenticity? Museums are standard bearers for truth in presentation. Their exhibitions often feature important (and of course, fully authenticated) examples by a particular artist(s)/genre/period or theme(s) that advances knowledge and understanding, often in groundbreaking fashion. Amongst art academicians, fidelity to the rightness of the object has led to instances of not so private differences of opinion. Examples include: the 2008 controversy as to whether The Colossus, a large scale iconic work that hangs in Madrid's Prado Museum was, or as has now been suggested, was not painted by the great Spanish master Francisco Goya; and the 2009 'rediscovery' by The Metropolitan Museum of Art, New York, of a portrait now said to be painted by another great Spanish artist, Diego Velazquez. Previously the Met catalogued this portrait as being only by the 'school of' or 'workshop of' Velazquez.

An object that is published or exhibited as authentic, but which then proves not to be, can ruin reputations and cause scandal, and is no less disastrous as a discredited object being sold, knowingly or otherwise, for

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vast sums of money to an aggrieved third party. The Metropolitan Museum's 1973 acquisition of 25 early Chinese paintings, later suspected to be modern day forgeries, is no less damning, and makes no less a mockery of scholarship than the very recent case involving a family suing one of Manhattan's most prestigious art galleries (Knoedler & Company) over the multi-million dollar sale of a purportedly fake Mark Rothko painting.

As in nearly all professions in which practitioners are more or less loosely ranked in a pecking order, most artists paint, draw or sculpt in relative anonymity. The market for most artist's work – when an she or he is fortunate enough to sell his/her work on a consistent basis – is typically limited to a particular geographic locale and sold in a lower end or co-op gallery, rarely necessitating the publication of a raisonne for their work, as potential controversies involving their artwork and its authenticity rarely, if ever, arise, and given the often modest sums for which their artwork sells forgers do not find it profitable to produce fakes of their works.

It is the work of artists of notoriety as denoted by rank within the context of major art historical categories/movements/periods/inclusion of works in museums and galleries and whose works trade for considerable sums in the primary and secondary markets for whom the need to ensure authenticity is generally requisite (e.g. was a painting actually executed by Cezanne or might it have been executed by Cezanne?).

For centuries, however, rare and valuable art and antiques have been faked, with the specific intention to deceive, and copied, typically by a student or follower of a master, or an admirer of a master's work. Forgers seek to meet demand by creating supply (of fakes). Copyists may or may not create works with the specific intention to deceive. Art and antiques created by both forgers and copyists, provided they are skilled renditions of the original, muddle markets and rattle long held art world beliefs and genres have badly damaged the legacies of some artists (e.g. Jackson Pollock and Amedeo Modigliani, to name but two) due to uncertainties concerning the authenticity of some of their oeuvre and sometimes casting doubt upon entire genres (e.g. early 20th century Russian modernist painting).

With current prices for much top tier fine art and antiques realizing millions of dollars, and in some cases over $100M in both the primary (non-resale) and secondary (resale/auction) markets, the layperson would understandably presume that surely an international agency or governing body establishes and regulates all matters pertains to establishing authenticity in the fine arts and antiques markets. Such a universal body should have functions akin to those performed by a governmental agency such as the Securities and Exchange Commission relative to its duties in the regulation of stock markets,…"to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation" (www.sec.gov).

Question: What governing body, whether private or governmentally sanctioned, regulates all matters concerning authenticity in the fine arts including laws protecting consumers from fraud or malfeasance in the primary or secondary markets?

Answer: There is no such single governing body regulating authenticity in the fine arts. A headline on the cover of the February 2012 ARTnews magazine concisely addresses this void in fine art regulation: "Authenticity: Who Decides?" while "Who's to Say It's Real?" is the title of a March 2012 article in Art + Auction magazine.

The art industry as a whole, however, does not operate willy-nilly in a lawless void. Instead, the industry, including art dealers, museums and auction houses self-regulates, essentially following usual and customary practices concerning the determination of authenticity (note: for purposes of this article, authenticity in the fine arts only – paintings, watercolors, drawings, prints and sculpture – have been considered).

Catalogues raisonnes (literally: reasoned catalogues, in French), a book, or series of books that list all known works by an artist that document every known authentic work in various media by artists of top-tier status, as well as many printmakers of the 20th century are considered the gold standard in the industry when it comes to the conferring the final verdict on authenticity. Inclusion of a work in that artist's catalogue raisonne means the work is considered authentic; exclusion of a work in that artist's catalogue raisonne means the work is either not considered authentic, or that the author(s) of the raisonne cannot definitively conclude that the work is authentic. Sometimes a raisonne will include a work previously given to an artist, but which, with the benefit of additional knowledge, research and peer consensus, has been downgraded as to a work that is now said to be 'attributed to' or 'after' that artist's hand. This distinction in terminology denotes that a work is now regarded as possibly, but not definitely executed by that artist. Such a work is considered to be by the hand of another artist working in the master's atelier, a work of the period by a follower of the artist, or

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a work by a follower of a later artist/copyist based on the master's original composition, depending on the specific categorization (most of the larger auction houses have no fewer than seven such authorship distinctions within their 'glossary of terms': by Raphael (for example); attributed to Raphael; studio of Raphael; circle of Raphael; style of/follower of Raphael; manner of Raphael and after Raphael. In descending order, each of these designations indicates a given work's connection to the hand of the master is increasingly indirect).

The author(s) of the raisonne is a recognized expert in the field – whether an independent scholar, museum curator, or art dealer – who has extensively studied and written about the artist and his/her oeuvre over a period of many years. A caveat, of sorts, must be recognized for holders of droit moral under French law [translated literally as 'moral right'] – a relative of the artist, or one who worked closely with the artist – authorized to render judgments concerning authenticity of artworks assigned to that artist. (Holders of droit moral are often criticized as nepotists insufficiently knowledgeable about an artist's work to render pronouncements about authenticity.

What about authenticity judgments that are needed for recognized, albeit not top-tier artists for whom catalogues raisonne do not exist? In such cases, auction house experts, independent appraisers and art dealers will rely on the judgments of persons who have either authored monographs on an artist and his/her work or have expertise in a particular area/period (e.g. 17th century Neapolitan paintings) as well as museum curators who have organized important exhibitions for that artist or the period, movement or genre with which that artist has an association. Such persons serve as the experts and are usually recognized in the field as the final word in judging authenticity. Experts with this standing are generally cited in text that accompanies descriptions of an artwork in publication such as an auction catalogue. A typical auction catalogue entry for such an artwork is: "Professor Jones has confirmed the authenticity of this lot," or "We wish to thank Professor Jones of the New York Academy of the Arts for her assistance in cataloguing this lot." Similar entries are used in auction catalogues for artworks included in raisonnes. Typically these entries are modified based on the expert and her/his physical/non physical examination of the object itself. (e.g. "Professor Jones has confirmed the authenticity of this lot… on the basis of first hand inspection... or…on the basis of photographs").

These distinctions in the degree to which some experts require physical examination of an artwork to render an opinion, while other experts do not, are one of the inconsistencies relating to methodology in the authentication process. Other such inconsistencies include the requirement by some experts that their decision making work be fee-based, with other experts rendering decisions at no cost. Finally, some experts will not engage in this process until the owner of the artwork in question signs a multi-page release form, indemnifying the expert from litigation should the owner question or disagree with the expert's verdict.

Whatever stipulations an expert requires prior to stating an opinion concerning authenticity, raisonne author(s) or leading expert(s) for an artist/period, upon acceptance by general consensus within the fine art field auction houses, dealers, galleries and museums serves as the definitive arbiter about the rightness of an object, which thus imbues her/him with considerable decision-making power as well as exposing him/her to considerable pressures and often criticisms about their judgments.

In the seminal work concerning fine art authenticity and related topics, The Expert versus the Object: Judging Fakes and False Attributions in the Visual Arts," (Ronald D. Spencer, editor, New York, 2004), co-author Francis V. O'Conor lists three tools that are relied upon by experts to determine authenticity in the fine arts:

1. Scientific analysis
2. Historical documentation
3. A connoisseur's visual inspection

Of these three tools, it is connoisseurship, the intangible knack of possessing a so-called 'good eye,' rather than an undisciplined, unschooled pejoratively termed 'wooden eye;' the former possessing the ability, acquired after years or decades of seeing and then recognizing hundreds of the artist's authentic works and an equal number, if not more, of copies and forgeries of that artist's work, to discern an artist's unique style of depicting his/her subject, the specific manner in which he/she renders forms and the artist's technique.

Two of the many issues that have plagued an expert's ability to definitively render declarative judgments concerning authenticity include:

1. Competing views from one or more recognized experts about the authenticity of an object. In such cases, dealer(s) and auction house(s) will typically align themselves with the views of a favored, more respected expert.

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2. Lawsuits brought against experts by plaintiffs contesting opinions.

The first issue is one that is historically a function of evolving scholarship (e.g. in the 1920s an expert might authenticate a Rembrandt that in 2012 may well be downgraded as not being by Rembrandt). In the modern era, an example of competing views by different experts concerns the views of experts with competing views regarding the work of Amedeo Modigliani, the famed Italian abstract portrait painter. "Modigliani/The Experts Battle: Lawsuits and charges of slander multiply as two scholars compete to be recognized as the ultimate authority" according to an article in the January 2004 issue of ARTnews magazine.

In The New Complete Van Gogh, author/expert Jan Hulsker questions the authenticity of no fewer than 45 paintings previously given to the Dutch master, including previously undisputed Van Gogh paintings in the prestigious Musee d'Orsay, The Metropolitan Museum of Art, and remarkably, The Van Gogh Museum.

The second issue is the greater threat, as noted in a headline in the December 2011 issue of The Art Newspaper: "The Law vs. Scholarship: Taking academics to court over authentication issues is eroding independent expertise." The current, very real possibility of being sued as an art expert whose judgment concerning the authenticity of an artwork may be brought into question by an aggrieved collector or dealer, and the associated costs of defending against lawsuits has prompted, of late, a number of expert committees to disband, including the Andy Warhol and Jean-Michel Basquiat authentication boards. Subject to the latest recognized expert/committee decision, one may now own a painting that was at one time regarded as an original, authentic work but is now considered to be a copy, fake or variation of the original painting by an unknown, lesser hand. This outcome may occur, notwithstanding that the painting in question has excellent provenance (known history of a work), e.g. was acquired from an important collection. In some cases, artworks can remarkably be considered 'not right' although they were once included in an earlier catalogue raisonne. Once downgraded, these works have essentially no market value and/or are consciously avoided by market players because of their non-acceptance by the leading expert/committee.

In regard to purportedly original Andy Warhol works rejected by the soon to be extant Warhol Foundation, unhappy non-Warhol art owners bemoan the Foundation's decision making process on at least two grounds:

1. Warhol's 'factory' approach to silkscreening his works meant that many of his 'originals' were completed by studio assistants, though based on Warhol's conceptions. This disconnect between Warhol – the 'idea person' and his print makers working under Andy's direction (screenprinting being Andy's favorite medium) should not serve as grounds for rejecting a would-be authentic Warhol, goes the argument.

2. Some contend that the Warhol Foundation, which owns a large stock of authenticated Warhol art, has systematically rejects some would be Warhol works in order to maintain control of the pop art master's market.

Is there a way to rectify these inconsistencies and flaws in the fine art authentication process? Can a regulated, overarching process implemented on an international scale be established to formally oversee fine art authentication? Such a system would ensure that fakes, forgeries and dubious works would be vetted from the market, stifle critics who decry the current system's somewhat ad hoc, inconsistent (and occasionally subjective, say some) authentication processes and provide a much needed dose of credibility to, and acceptance of all expert decisions. This kind of regulated system has at least three other beneficial effects:

1. Transactions between parties in which fine art is treated as a fungible commodity in an ever growing international art market or when fine art is used as collateral – would not be hampered by concerns/questions involving the legitimacy of the currency

2. To affirm or deny the authenticity of disputed fine art in private and public collections that does not trade between parties

3. Aid appraisers and insurers in the accurate assignment of values of fine art based upon universally accepted authenticity assessments

An advocate of such a system is Francis V. O'Connor, cited above, who optimistically proposes… "an umbrella capable of administering the services of a group of wide-ranging advisory panels experienced in the various aspects of the

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authentication process and the various media and periods that process must address." O'Connor goes on to argue that all decisions pertaining to the authentication of fine art would be published, that all decisions would have to be agreed upon by three or more experts following clear procedures, and that this.. "umbrella organization would fight any lawsuits brought against itself and its member experts." (The Expert versus the Object, op.cit., pp. 22-3)

In light of the one-two punch of the dissolution of some authentication committees necessitated by the egregious costs of defending lawsuits coupled with the meteoric rise in prices for works by top tier artists, O'Conor's utopian proposed system may ultimately be borne of necessity. By requiring uniformity and transparency in the authentication process and eliminating inconsistencies and taxing procedures involved is some present day authentication of artwork, the overall integrity of the art world is enhanced.

A contrarian might argue, however, that even if enacted, O'Conor's umbrella organization may well run headlong into at least several obstacles:

1. While an established, respected peer group of experts will prove to be a more formidable foe when pitted against a complainant, it will not stop an aggrieved plaintiff from suing these experts – in fairness, a point that O'Conor acknowledges.

2. Even a group of three or more experts may refuse to render a unanimous decision about an artwork's authenticity on a borderline call. To wit: in 2008, a complaint was filed against the Basquiat committee, comprised of at least four members, when it refused to render an opinion concerning the authenticity of a purported Basquiat work. The committee would not say that the 'Basquiat' work was authentic, and would not say that the work was not authentic. A non-decision as the final verdict, has in practice, the same effect on sealing the fate of the artwork as a vote of non-authenticity.

3. Finally, connoisseurship – even when evaluations are arrived at by experts whose bona fides are uncontestable – is predicated on discriminating taste and accrued visual sensibility and is thus not a hard science. It is subject to human foible. The secondary market is rife with 'sleepers' discovered by the sharpest of art sleuths who seek to identify artworks/antiques that are undervalued, misidentified/unidentified. Witness the 1998 sale at auction of the drawing of a lady in profile which sold for $21,850. Originally catalogued by the auction house as by an unknown artist, "German School, early 19th century," the drawing resurfaced in the market two brief years later as a $150 million original Leonardo da Vinci drawing, or so one group of experts claim. However, were these 21st century da Vinci experts alive to witness first hand if the Renaissance master was or was not the artist of record?

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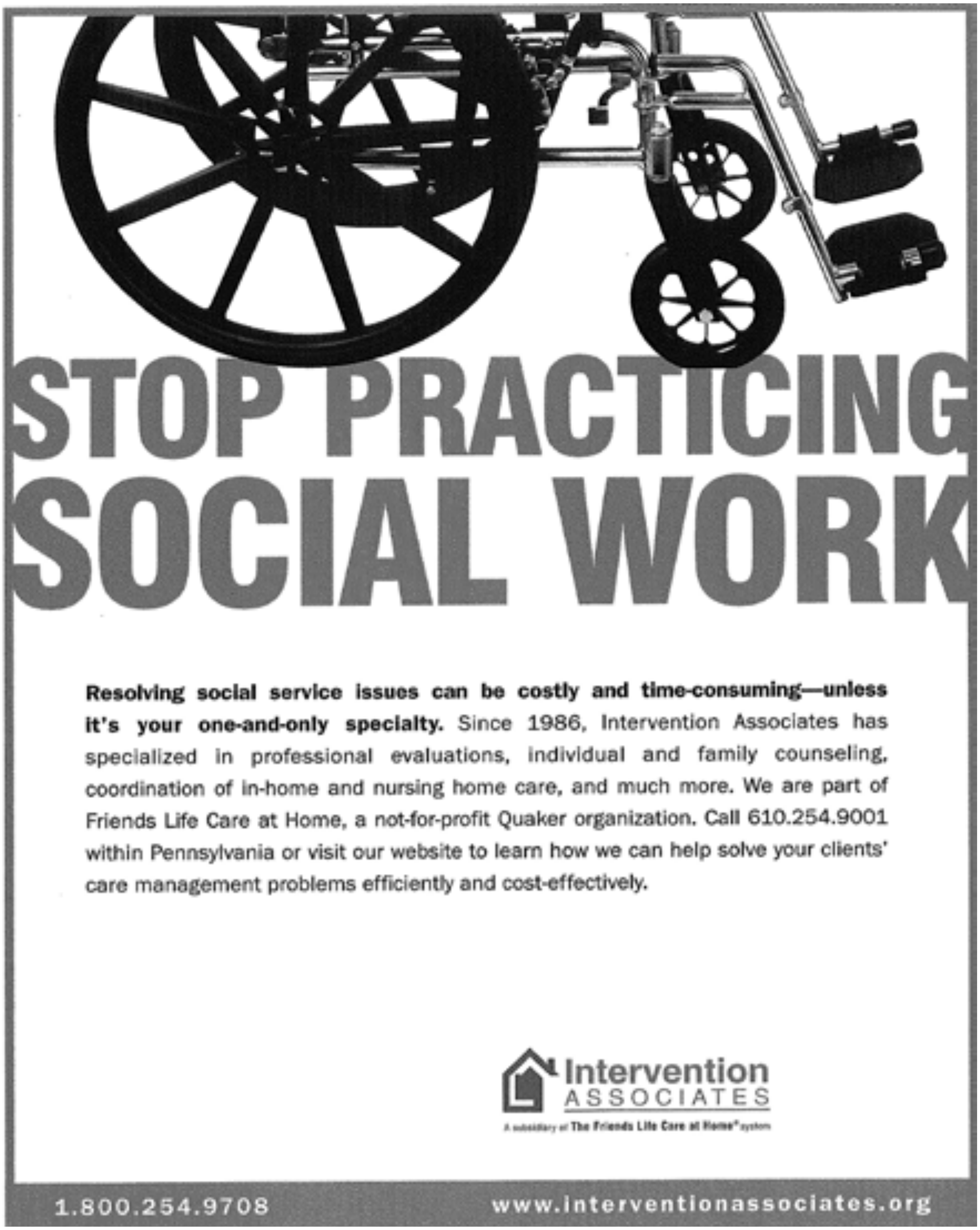
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Case Summaries from the Orphans' Court Litigation Committee

In Re: C. Richard Johnston Irrevocable Trust, O.C. 2011-135 (O.C. Crawford, January 19, 2012)

By TIMOTHY J. HOLMAN, ESQUIRE AND BRADLEY D. TEREBELO, ESQUIRE
HECKSCHER, TEILLON, TERRILL & SAGER, P.C.

Pennsylvania law provides that "all beneficiaries and trustees of a trust may enter into a binding nonjudicial settlement agreement with respect to any matter involving the trust." 20 Pa. C.S. §7710.1(b). However, a nonjudicial settlement agreement "is valid only to the extent it does not violate a material purpose of the trust and includes terms and conditions that could be properly approved by the court under this chapter [20 Pa. C.S. §§ 7701 et seq.] or other applicable law." 20 Pa. C.S. §7710.1(c). Matters that may be resolved by nonjudicial settlement agreement include, but are not limited to, the modification or termination of a trust. 20 Pa. C.S. §7710.1(d). "Any beneficiary or trustee of a trust may request the court to approve a nonjudicial settlement agreement to determine . . . whether the agreement contains terms and conditions the court could have properly approved." 20 Pa. C.S. §7710.1(e).

The Crawford County Orphans' Court in *Johnston* analyzed when a nonjudicial settlement agreement may violate a material purpose of the trust. In *Johnston*, the settlor created an irrevocable trust in 1981. The settlor died in February 2007 survived by his wife and several children and grandchildren. The trust provided as follows:

Upon Settlor's death if Settlor's wife survives, the Trustees shall pay to, or expend for her benefit, during her life, income and principal whenever the Trustees determine that the income from Settlor's wife from all sources known to the Trustees is not sufficient for her reasonable maintenance and support. In addition, the Trustees may in their discretion pay to, or use for the benefit of, one or more of the Settlor's then living issue so much of the income and principal of this trust as the Trustees determine to be required for their reasonable maintenance, support and education.

In June 2007, the then-serving trustees, settlor's wife and all of settlor's children and grandchildren entered into a nonjudicial settlement agreement pursuant to 20 Pa. C.S. §7710.1 to modify the trust. In the agreement, the descendants of the settlor gave up their right to receive discretionary distributions of income and principal during the lifetime of the settlor's wife, and the trust was further modified to provide that each year the settlor's wife was entitled to a 4% unitrust distribution from the trust.

In 2011, one of the successor trustees of the trust and two of the settlor's children filed a petition to void the agreement, arguing that, because the agreement "was not approved by the Court as required by 20 Pa. C.S.A. §7740.1(b) and because the material purpose of the original trust was improperly negated by that Family Settlement Agreement, it should be voided ab initio." The settlor's wife and two of the settlor's other children filed an answer, arguing that the agreement was governed by 20 Pa. C.S. §7710.1 (which does not require court approval to be effective), not §7740.1 (which does require court approval), and that the agreement did not violate a material purpose of the trust.

The court first addressed whether 20 Pa. C.S. §7740.1(b) or §7710.1 governed. Section 7740.1(b) provides that a "noncharitable irrevocable trust may be modified upon the consent of all the beneficiaries only if the court concludes that the modification is not inconsistent with a material purpose of the trust." 20 Pa. C.S. §7740.1(b) (emphasis added). Because the agreement was a nonjudicial settlement agreement signed by all of the beneficiaries and trustees of the trust, the court concluded that the provisions of 20 Pa. C.S. §7740.1(b) did not apply and instead the provisions of 20 Pa. C.S. §7710.1(b), "which allows a Settlement Agreement to be reached by all the beneficiaries and trustees of a trust[,]" governed.

The court then analyzed whether the modification of the trust pursuant to 20 Pa. C.S. §7710.1 was proper. The court concluded that an evidentiary hearing was unnecessary

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ETHICS COLUMN

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

Is a lawyer required by the Rules of Professional Conduct to assess the capacity of his or her estate planning clients?

We lawyers automatically and subconsciously "size up" all of our clients when we first meet them and do so throughout our representation. While we normally do not think of it as an assessment of capacity, that certainly is, at least in part, what goes on. When we are with a client long enough and have learned to ask the right questions, we also may begin to sense when a client suffers from diminished capacity. Sometimes, the family calls our attention to the fact that our client is slipping. When the client's diminished capacity becomes apparent, the assessment issue looms larger because of the importance of the client's having the capacity to execute the documents we have been called upon to prepare.

An informal assessment of a client's mental capacity is impliedly, if not explicitly, required by the Rules of Professional Conduct. A lawyer is required to be thorough and to properly prepare (Rule 1.1), to abide by the client's decisions after consulting with the client (Rule 1.2), to be diligent (Rule 1.3) and to reasonably counsel with the client about the means by which the client's objectives are to be accomplished (Rule 1.4(a)(2)). Unless the client can adequately comprehend and communicate his or her wishes without the intervention of others, the lawyer will not be able to fulfill his or her ethical duties if he or she proceeds with the assignment.

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Case Summary, continued

and that, pursuant to the plain language of the trust, the nonjudicial settlement agreement violated a material purpose of the trust for two reasons. One reason was that the agreement "took away the ability of [the settlor's descendants] to receive disbursements from income and principal of the trust during the lifetime of the widow if the trustees determined that those disbursements were necessary for that beneficiaries [sic] '… reasonable maintenance, support and education.'" The other reason was as follows:

With regard to [the settlor's] widow, he did, however, restrict her to only receiving disbursements if the remaining trustees determined that she didn't have enough income from all sources that was sufficient for her reasonable maintenance and support. Clearly the terms of the Family Settlement Agreement violated that material purpose of the trust. It changed what could have been a $0 disbursement to the widow to an automatic disbursement each year and that clearly was not the intention of the Settlor. By the unambiguous language of the trust, he wanted his widow to be cared for properly during her lifetime with trust funds if she needed them, but he also wanted to preserve the funds for his other beneficiaries by limiting his widow to only receiving disbursements when she did not have other funds '… sufficient for her reasonable maintenance and support.'"

Accordingly, the court invalidated the nonjudicial settlement agreement. However, because the petitioners consented to the settlement agreement initially, the court refused to void the settlement agreement ab initio (June 2007), as was requested by the petitioners, and instead invalidated the agreement as of the date of the petition to invalidate the agreement (filed in September 2011). The court therefore ordered the wife to repay to the "beneficiaries of the trust, pro rata, any disbursements she received from the trust as a result of the provisions of the June 5, 2007 Family Settlement Agreement from September 15, 2011 forward." In addition, the court directed that the respondents bear the payment of the costs of the action, but not the petitioners' attorney's fees (as was requested by the petitioners).

To avoid potential uncertainty with nonjudicial settlement agreements being set aside at an indeterminate later date, as occurred in *Johnston*, practitioners may wish to advise clients who are entering into a nonjudicial settlement agreement to obtain court approval of the agreement pursuant to 20 Pa. C.S. §7710.1(e) contemporaneously with the execution of the agreement.

Ethics Column, continued

Fortunately, the Rules of Professional Conduct provide some guidance about conducting assessments, and the standards of capacity for execution of documents has been established by a statute and case law.

Rule 1.14(a) provides that when a client suffers from diminished capacity, the "lawyer shall, as far as reasonably possible, maintain a normal client-lawyer relationship with the client". Comment 6 to the Rule, says that when determining the extent of a client's diminished capacity, "the lawyer should consider and balance a number of factors," including "the client's ability to articulate the reasoning leading to a decision" and "to appreciate the consequences of a decision".

We also must determine if the client has the level of capacity necessary to execute the documents. That includes the capacity to retain counsel. An engagement agreement is a contract. To have the mental capacity to enter into a contract, one must have "sufficient intelligence" to "comprehend the nature and character of the transaction." *Taylor v. Avi*, 415 A.2d 894 (PA. Super. 1979).

There is a practical reason to determine a client's capacity to retain the services of a lawyer. A lawyer's retainer agreement has been deemed void because of the client's incapacity, and the fee reduced to a quantum meruit basis. *Gregory Estate*, 27 Fid. Rep. 2d 273 (Phila. 2006).

By statute, one must be of "sound mind" to execute a Will. The courts have said that knowing the "natural objects of one's bounty", the value and knowledge of the property, and being able to convey one's wishes, when combined, meet the standard. *Cohen's Estate*, 445 Pa. 549, 284 A.2d 754 (1971), and *Milleman's Estate*, 415 Pa. 261, 203 A.2d 202 (1964).

There are no statutes or appellate decisions that have set the mental capacity required to execute a Power of Attorney. However, Orphans' Court decisions have held, essentially, that it requires an understanding of the (1) statutorily required notice, (2) nature of the authority being granted, and (3) assets subject to the Power. *Bosley Estate*, 1 Fid. Rep. 3d 185 (York 2010); *DiStefano Trust,* 30 Fid. Rep. 2d 1 (Phila. 2009); and *Robinson, An Incapacitated Person*, 28 Fid. Rep. 2d 65 (Montg. 2008).

The informal assessment of the client's capacity to execute these three basic documents can be easily performed during the first client meeting by asking a series of "POLITE" questions. The questions are designed to elicit the client's ability to name his or her family (natural objects of one's bounty) and other important persons in his or her life (P), assets he or she owns (O), awareness and orientation as to location (L), the nature of current involvement and interests (I), awareness and orientation as to time (T), and knowledge of current and important events (E).

Asking POLITE questions and documenting the discussion will help the lawyer fulfill his or her objective of assessing each client's mental capacity. It also provides a checklist to assure that all important issues are discussed and that the discussion will be more easily remembered when the important meeting or execution memorandum is prepared for the file after the session. That memorandum could be an important refresher for a lawyer called later as a witness in a Will contest. As the testimony of the scrivener is given great weight in Will contests, that testimony could be the most important factor in assuring the client's wishes are carried out.

A publication that every trust and estate practitioner should have is "Assessment of Older Adults With Diminished Capacity: A Handbook for Lawyers" published by the American Bar Association and American Psychological Association in 2005.

WHAT WOULD YOU LIKE TO SEE IN FUTURE ETHICS COLUMNS?

Send your questions and ideas to:

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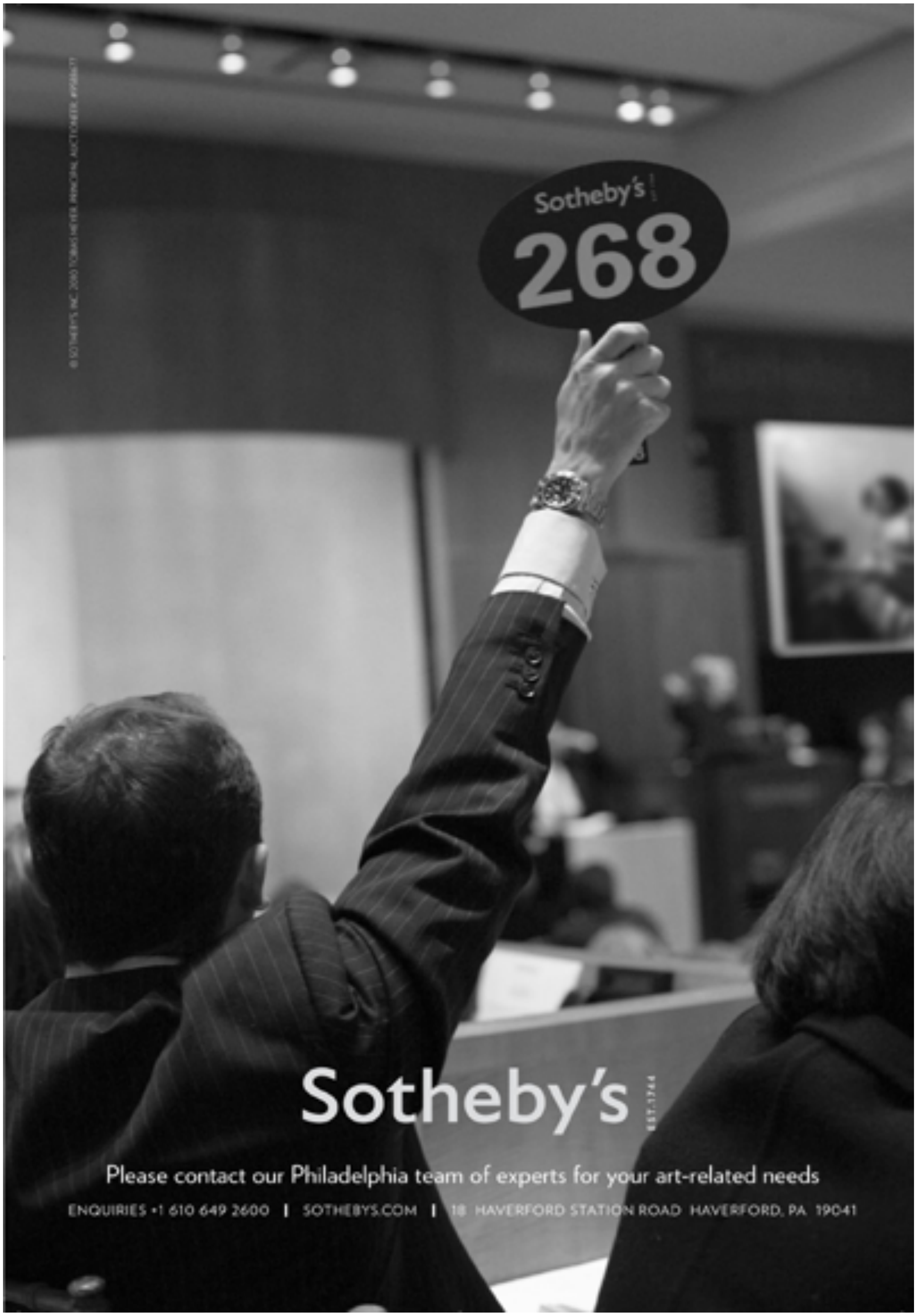
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TAX UPDATE

By MARGERY J. SCHNEIDER, ESQ., LLM (Tax)
ROSENN, JENKINS & GREENWALD, LLP

FEDERAL ESTATE TAX EXTENSION TO FILE FORM 706 TO ELECT PORTABILITY

Notice 2012-21 (February 17, 2012)

The IRS granted a six-month extension to file Form 706 to executors of estates qualifying for the portability election under IRC § 2010(c)(5)(A) who failed to file Form 4768 (Application for Extension of Time to File a return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes within nine months after decedent's date of death. The application for an extension must be filed no later than fifteen months after decedent's date of death. Under Section 20.6081-1(c), Form 4768 must contain a detailed explanation of why it is impossible or impractical to file a "reasonably complete" Form 706 by the due date, and an explanation demonstrating "good cause" for not requesting the automatic extension by the due date.

This notice applies to the estate of any decedent whose date of death is after 12/31/2010 and before 7/1/2011, who is survived by a spouse, and whose gross estate does not exceed $5,000,000.

The executor can demonstrate "good cause" by filing Form 4768 at the proper IRS office and entering at the top of Form 4768 the notation "Notice 2012-21, Extension for Good Cause Shown" or otherwise notify the IRS that Form 4768 is being filed pursuant to Notice 2012-21. No other explanations are necessary.

Except in the case of an executor abroad, the IRS cannot grant additional extensions of time to file Form 706.

ESTATE INCLUSION OF FAMILY LIMITED PARTNERSHIPS

Estate of Stone v. Comm'r, T.C. Memo. 2012-48 (February 22, 2012)

The Tax court held that the value of family limited partnership interests consisting of woodland parcels was not includible in a decedent's estate under IRC §2036 because the transfer of these parcels was a bona fide sale for full and adequate consideration.

Joanne Stone, the Decedent, a resident of Crossville, Tennessee, died in 2005 at age 81. She had been in good health until then. She had six adult children and a close-knit extended family. She owned, in whole or in part, approximately 740 acres of mostly undeveloped woodlands (the "Woodland Parcels"). Her son built a home and constructed a lake near this property. In order to facilitate the process of gift-giving to family members and protect against partition suits, Decedent and her husband deeded the Woodland Parcels to a limited partnership (SFLP) in 1997, with themselves as general and limited partners. In the next four years they gifted 98% of SFLP to family members and their spouses and each retained 1% general partnership interests.

The value of the Woodland Parcels, which was appraised at $1,565,600, was not discounted for gift tax purposes. The Stones paid the $700 annual property taxes from their own account.

The Court ruled that the inter vivos transfers constituted a bona fide sale because Decedent had a "legitimate and actual nontax motive in transferring the woodland parcels to SFLP.

The Court ruled that Decedent received full and adequate consideration for the transfer because it found that Decedent had a legitimate and actual nontax purpose in transferring the property. The transfer represented something other than a mere attempt to change the form in which Decedent held the property.

Estate of Kelly v. Commissioner, T.C. Memo. 2012-73 (March 19, 2012)

The Tax Court found the value of gifted limited partnership interests should not be included in a decedent's estate because the limited partnership in question was established for legitimate nontax purposes and the management fee to the general partner was not a retention of income by the Decedent.

Decedent, Beatrice Kelly, was incapacitated by Alzheimer's and her children had been appointed co-guardians in 2001. In 2003, in order to equalize the shares of her estate and for protection against liability, the co-guardians successfully petitioned the Superior Court in Georgia for permission to transfer real estate and

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liquid assets to four limited partnerships. One of the limited partnership benefitted each child. A corporation (the "Management Corporation") was named general partner and was given a special allocation of the net income of the limited partnerships to pay their operating expenses and to pay Decedent's personal expenses, if necessary. Although the children were officers and directors of the Management Corporation, Decedent retained ownership of 100% of the stock and paid a salary to the children for their services to the Management Corporation. Gifts of partnership interests were made to the children for 3 years until her death in 2005.

The IRS determined a deficiency of $2.2 million, claiming that the assets contributed to the partnerships were includible in Decedent's estate under IRC §2036(a). However, the estate was able to prove that the transfers to the limited partnerships met the bona fide sale for full and adequate consideration exception of IRC §2036(a) for the following reasons: 1) the family's primary concern was to ensure the equal distribution of decedent's estate and to avoid litigation; 2) other concerns included the need for active management and potential liability related to Decedent's assets, which made the formation of an entity a prudent decision; 3) there was no evidence that tax savings motivated the formation of the limited partnership. Thus there were valid nontax reasons for the contributions of property to the partnerships. Moreover, Decedent received interests in the partnerships that were equal in value to the assets she contributed.

The court also held that there was no retained possession or enjoyment by the Decedent under IRC §2036(a). She respected the partnerships as separate and distinct legal entities, observed partnership formalities and kept enough assets out of the partnerships for her personal needs. The court denied that the management fees paid by the partnerships were "an express retention of income by decedent in the partnership interests," which would have made them includible in her estate. The profit made by the Management Corporation after paying salaries to the children could not be considered a legally binding directive to provide support and maintenance to Decedent. Moreover, the management fees were reasonable and below industry standard. Since Decedent could not manage the partnerships herself, she had a bona fide reason for creating the Management Corporation to manage them. She did not retain an interest in the transferred limited partnership interests.

Estate of Turner v. Commissioner, 138 T.C. No. 14; No. 18911-08 (March 28, 2012), supplementing T.C. Memo. 2011-209.

The Tax Court left intact a 2011 decision which held that the assets of a family limited partnership were includable in a decedent's estate under IRC § 2036(a) at their full market value and that the value of partnership assets that were attributable to partnership interests that the decedent had gifted to his descendants during his lifetime did not qualify for a marital deduction.

In its 2011 decision the Tax Court had ruled the assets includable in the estate because it did not find a legitimate and significant nontax reason for the formation of the family limited partnership. Upon review, the Tax Court ruled that there was no new substantive evidence to make them change their mind.

The Court did not address the marital deduction issue because that issue was not before the court. The IRS had allowed a marital deduction only for the portion of the family limited partnership assets as revalued under IRC § 2036 that were transferred to the surviving spouse under the decedent's will.

VALUATION

Estate of Smith v. United States, No. 07-676T, 2012 WL 591506 (Fed. Cl. Feb. 13, 2012)

The Federal Claims Court upheld the IRS and applied IRC § 2704 to significantly increase the estate tax value of a decedent's stock holdings.

Before Decedent's death, he owned Class A common shares of the Five Smith's, Inc., which was formed to operate an NFL franchise. Each share was entitled to 11.64 votes. When he died, pursuant to the terms of the Five Smith's Articles of Incorporation, which had been modified in 1991 to this effect, his shares were automatically converted to Class B shares, which had only one vote per share.

The IRS argued that the effect of this conversion, a lapse of the enhanced voting power of the Class A shares, meant that under IRC § 2704 the enhanced voting power of the Class A shares should be used to value the shares. It valued the shares at $30 million on the date of death. The estate argued that the enhanced voting power disappeared at death and that the proper valuation was fair market value of the Class B shares, which was only $22.5 million.

The estate made three arguments: 1) It argued that the family did not have control of the company under the IRC § 2704 definition of

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Tax Update, continued

the term, because it did not have the power to reverse the lapsing of the voting power that occurred at Decedent's death. The Court of Claims rejected the estate's arguments, which the estate had adopted from the legislative history of the statute. It pointed out that both before and after Decedent's death, his family held more than 80% of the voting power of the company, far more than the 50% that was required under IRC § 2701(b)(2)(A). 2) The estate also argued that the lapse actually occurred in 1991, at the time of the modification of the Articles of Incorporation, and not in 1997, upon Decedent's death. IRC § 2704 was enacted until 1990. The estate claimed that the lapse should thus be considered an inter vivos transfer for adequate and full consideration and not a testamentary transfer subject to estate tax. However, the court followed the examples in the Treasury Regulations in ruling that the lapse occurred at death. See Treas. Reg. § 25.2704-1(f). 3) The estate argued that the 1991 limitations were a restriction on the sale of shares and thus represented a bona fide business arrangement under IRC § 2703. The court also refused to apply IRC § 2703, finding that it applied only to restrictions on the sale of shares, not on voting rights as in this case.

Estate of Lockett v. Commissioner, T.C. Memo. 2012-123 (April 25, 2012)

The Tax Court held that an estate held assets individually, despite the nominal existence of a limited partnership, and that most of the loans made by the nominal partnership were actually loans and not gifts.

Mrs. Lockett, in declining health, executed a limited liability partnership and funded it with cash and marketable securities from her living trust. The trust was later dissolved, making her the sole owner of the Partnership. Although the Partnership agreement listed her two sons as general partners, they contributed no assets to the Partnership. She received all of the Partnership income and was shown as 100-percent owner of the Partnership on its income tax returns. Although the Estate claimed that the two sons held 1 percent general partnership interests (or, in the alternative, an 11.68 percent general partnership interest), there was no evidence that they contributed property to the Partnership.

At her death, Mrs. Lockett's estate took a 40 percent discount on the assets in the Partnership. At trial, the estate and the IRS stipulated to the value of the underlying assets in the Partnership with no discount. The Court held that the estate was the direct legal owner of the underlying assets of the Partnership and disallowed all discounts. It reasoned that the Mrs. Lockett owned 100% of the assets and that no partnership existed.

SPECIAL USE VALUATION

Finfrock v. U.S., No. 3:11-cv-03052 (March 20, 2012)

Treas. Reg. § 20.2032A-8(a)(2) states that the IRC § 2032A special use valuation is only permitted if it is applied to 25% or more of an estate. The District Court ruled that Treas. Reg. § 20.2032A-8(a)(2) was invalid because IRC § 2032A was clear and contained no ambiguity that the Secretary of the Treasury needed to clarify.

Decedent owned four parcels of farmland in Illinois, which collectively represented 68% of her estate. The estate elected the IRC § 2032A special use valuation on the fourth parcel, on which an heir intended to operate a farm. The IRS disallowed the special use valuation and increased the valuation for federal estate tax purposes by $175,000, claiming that the parcel did not constitute 25% of the estate. The estate claimed that under the statute, qualified property must represent 25% of the estate, but that there is no special requirement for the special use election. The Court agreed and dismissed the IRS's argument that because the statute is silent on this point, the Secretary of the Treasury needed to promulgate the regulation to clear up the possible ambiguity created by this silence.

LIFE INSURANCE

Estate of Fujishima v. Commissioner, T.C. Memo 2012-6 (January 9, 2012)

The Tax Court ruled that the full face values of two life insurance policies and a note, of all of which the decedent was record owner at his death, were includible in decedent's gross estate.

Decedent's mother, who was his personal representative, argued that the note had no value because no value was specified on decedent's brokerage statement. The Court ruled that such documentation of its lack of value was inadequate and that it was unlikely that the note was worthless in the light of the value of the issuer's stock.

His mother also claimed that she had paid for the insurance policies and decedent had intended her to be the owner of the insurance policies, despite the issuing companies' records that decedent was the owner. The court ruled decedent was the owner because of the lack of any documentation to the contrary and because the inclusion of one of them on decedent's estate tax return could be considered an admission that de-

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cedent was the owner.

The Tax Court also disallowed deductions claimed on a decedent's estate tax return for executor's commissions and fees because the estate did not meet its evidentiary burden.

Estate of Kahanic v. Commissioner, T.C. Memo. 2012-81, No. 23800-09 (March 21, 2012)

The Tax Court ruled that life insurance proceeds were includible in a decedent's estate but also qualified as an estate deduction because they were a valid debt.

Before his divorce in 2004, decedent Dr. David Kahanic had obtained four life insurance policies. As part of the divorce settlement his wife received a promise to maintain a $1.2 million insurance policy and a $500,000 insurance policy to protect her child support and spousal maintenance payments, respectively. In a later order for non-compliance, Dr. Kahanic was ordered to maintain an additional $2.495 million policy. When he died in 2005, Mrs. Kahanic received the $2.495 million death benefit. Mrs. Kahanic made a loan to the estate of $700,000 of the proceeds to pay the estimated $970,000 in death taxes. Form 706 was filed to show the $2.495 million policy as an asset and as a debt of the estate.

The estate claimed that decedent had no incidents of ownership in the policy because he was under a court order not to cancel or change it. Alternatively, the estate argued that the policy had no net cash value, The court found that the policy was includible, noting that the policy had a cumulative value, was in force on the date of death, and would remain in effect for at least two years thereafter.

The estate successfully argued that Mrs. Kahanic was owed the full $2.495 million death benefit under IRC § 2516, which provides that a payment under a property rights judgment is considered a transfer for full and adequate consideration in money or money's worth and thereby satisfies IRC § 2053(c)(1)(A), which treats consideration for claims. The Court also ruled that the interest payable on the loan was a valid deduction under Treas. Reg. § 20.2053-3(a).

DECANTING

IRS Notice 2011-101

The IRS is inviting comments concerning the consequences for income, gift, estate, and/or GST taxes arising from the decanting of a trust, which it defines as "transfers by a trustee of all or a portion of the principal of an irrevocable trust (Distributing Trust) to another irrevocable trust (Receiving Trust) that result in a change in the beneficial interests in the trust." The public is encouraged to submit definitions of "decanting" and comment on the tax consequences of such transfers in domestic and foreign trusts. While this issue is being studied, the IRS will not issue PLRs with respect to such transfers that result in a change of beneficial interests. The deadline for comments is April 25, 2012.

Comments as to the relevance and effect of the following factors are also requested:

1. Beneficiary's right to or interest in trust principal or income is changed;

2. Trust principal and/or income may be used to benefit new beneficiaries;

3. Beneficial interest or power of appointment is added, deleted, or changed;

4. Transfer from grantor trust to nongrantor trust or vice-versa;

5. Situs or governing law of Receiving Trust is different from that of Distributing Trust, resulting in later termination date for Receiving Trust than for Distributing Trust;

6. Court order or Attorney General's approval is required for transfer under the terms of applicable law or the Distributing Trust;

7. Beneficiaries must consent to transfer under the terms of applicable law or the Distributing Trust;

8. Beneficiaries are not required to consent to transfer under the terms of applicable law or the Distributing Trust;

9. Consent of beneficiaries, court order or Attorney General's approval is not required but is obtained;

10. The effect of state law or silence of state law on scenarios 1-9 above;

11. Change in identity of donor or transferor for gift or GSTT purposes;

12. Distributing Trust is exempt from GSTT or has an inclusion ratio of zero;

13. Future power to make any of these changes is created.

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ESTATE INCLUSION OF GRANTOR RETAINED ANNUITY TRUSTS

T.D. 9555; 76 F.R. 69126-69131 (November 8, 2011) (affecting IRC Reg. §20.2036-1)

This Treasury Decision finalizes the remaining issues posed by regulations proposed in 2007 and finalized in 2008 concerning the determination of whether assets owned by a trust are includible in the estate of the grantor when the grantor has retained enjoyment of those assets for life, or for a period not ending before his or her death.

Applicable to estates of decedents dying after November 7, 2011, these regulations concern several areas:

1. If additional GRAT payments are to be received by a grantor's estate after the grantor's death, there will be no double counting under IRC §2036 and §2033. The GRAT interest is includible in the estate under IRC §2036 only.

2. If a decedent and a child (or another taxpayer) are both receiving GRAT payments, and the decedent has funded the GRAT, the amount included in decedent's estate is the value of the portion of property necessary to generate decedent's annuity payments plus the portion necessary to generate the other taxpayer's annuity payments, reduced by the present value of the child's interest at the time of death.

3. If a grantor retains an income interest that is effective only upon the termination of another taxpayer's interest, and the grantor dies first, his estate includes the amount that would have been necessary to produce the income amount if the grantor had lived long enough to receive it, less the present value of the other taxpayer's interest.

4. The method of calculating the amount includible in the grantor's estate when the grantor was entitled to an increasing annuity amount.

DEDUCTION FOR LITIGATION EXPENSES

Estate of Gill v. Commissioner, T.C. Memo. 2012-7 (January 9, 2012)

The Tax Court ruled that the expenses incurred by a decedent's children incurred in litigation with decedent's second wife were deductible. It also ruled that the marital deduction should not be reduced by the estate taxes reimbursed to the estate as part of the settlement of litigation over the trusts of the first wife.

Decedent, who was dying of lung cancer, remarried a few months after his first wife's death. In his new estate plan, he made his new wife the income beneficiary of a QTIP trust and credit shelter trust. He appointed the second wife his executrix and co-trustee of both trusts, along with a trust company. After his death, his two children and wife engaged in lengthy litigation involving an accounting of the trusts and a will contest. The will contest was settled by mediation, but the second wife did not honor the first settlement agreement. Seven years later, a second settlement agreement was reached, in which the estate was to reimburse the children's substantial legal fees. The Tax Court held that these fees were deductible because (a) reimbursement of the legal fees was allowed under applicable state (Florida) law: (2) the amount of the fees was reasonable; and (3) the fees were incurred because of litigation that was essential to the proper settlement of the estate. The Court held that the second wife's expenses incurred after the first settlement were not deductible because she incurred them personally and not for the benefit of the estate.

The Court also ruled that the state and federal taxes incurred by the decedent's estate should not reduce the amount of the marital deduction in the estate, because under Florida law all taxes attributable to amounts passing under a will or trust are paid from the residue of the estate unless the governing instrument specifies otherwise.

CLAIM AGAINST ESTATE FOR STATE INCOME TAXES

Marshall Naify Revocable Trust v. U.S., No. 10-17358, 2012 WL 470173 (9th Cir. Feb. 15, 2012)

The Ninth Circuit Court of Appeals held that a post-death settlement of a state income tax liability could be considered dispositive in establishing the value of the state's claim.

Decedent had avoided payment of California income tax on $660 million in capital gains until he died in April 2000. On its federal estate tax return, Decedent's Estate reported a claim against the estate of $62 million for the estimated amount that the Estate would owe California if the decedent's tax avoidance plan failed. At the time the federal estate tax return was filed, the state had not yet asserted a claim against the Estate. Both the state income tax return and the federal estate tax returns were audited. The IRS disallowed the $62 million deduction but allowed the Estate to deduct $26 million, which it paid to settle the California income

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tax claim. In 2006, the Marshall Naify Revocable Trust ("Trust"), successor in interest to the Estate, filed a claim with the IRS for a refund of the $11 million tax deficiency it had paid when the IRS adjusted its deduction. The IRS disallowed the claim because it stated that the California income tax claim was contingent and disputed. The district court found in favor of the IRS in 2010, and the Trust appealed.
The Ninth Circuit held that the post-death settlement was dispositive in establishing the value of the claim, because value of the claim was not "ascertainable with reasonable certainty" on the date of death.

GIFT TAX

Chief Counsel Advice 201208026 (February 24, 2012)

The IRS ruled that gift tax annual exclusions were not allowed for transfers to an irrevocable trust, because the transfers were completed gifts and withdrawal rights were unenforceable.

Donors made gifts to an irrevocable trust benefitting their children, other lineal descendants and their spouses, and named one child as sole trustee. Donors retained testamentary limited powers of appointment. If these powers were not exercised, the property would be distributed to the children upon both Donors' deaths. The trustee had absolute discretion to make distributions to the beneficiaries. Each beneficiary could withdraw gifts made to the trust up to the annual exclusion amount, but the trustee could void this power for additions made to the Trust. The Trust was to be construed and administered according to the law of the relevant state, but all questions and disputes were to be submitted to an "other forum," which would enforce the Trust provisions.

Donors claimed that the gifts were incomplete because Donors retained dominion and control over the gifted property through their testamentary limited powers of appointment but no power over the distributions to the current beneficiaries. The IRS stated that the gifts were complete because Donors were not able to control distributions or change the beneficiaries during their lives.

The IRS determined that the gifts did not qualify for the gift tax annual exclusion because no-contest and arbitration provisions in the trust agreement rendered the Crummey powers of the beneficiaries ineffective.

U.S. v. Dickerson, T.C. Memo. 2012-60 (March 6, 2012)

The Tax Court ruled that a taxpayer's transfer of her interest in a winning lottery ticket to a corporation owned 51% by family members and 49% by her, resulted in a taxable gift.

In 1999, Tonda Dickerson received a winning lottery ticket as a gift from a regular customer in the restaurant where she worked. The cash payout was $5 million (or $10 million if paid out over 30 years). Although her family customarily purchased lottery tickets and talked about sharing the winnings, there was no written sharing agreement for the lottery proceeds.

The day after the formation of the family corporation, Ms. Dickerson was sued by her co-workers, who claimed that under a pre-existing agreement, she was required to give them 80% of the prize money. A state court found in favor of the co-workers but the Alabama Supreme Court overturned the ruling.

The IRS claimed that she made a taxable gift of $2.4 million by transferring the lottery ticket to the corporation. The Tax Court agreed with the IRS and held that there was no enforceable contract to share the prize winnings with her family. It stated that the terms of the agreement were too indefinite and incomplete, and that there was no established pattern of purchasing tickets, pooling of money, or predetermined sharing percentages. Moreover, even if such an agreement were enforceable as a contract, it would be void under the Alabama antigambling laws.

U.S. v. MacIntyre, 109 AFTR 2d Para. 2012-624 (DC TX 3/28/12)

The District Court ruled that the income beneficiary of a trust must pay gift tax on a trust that had terminated and paid out its entire principal to the remaindermen.

A 10-year grantor retained income trust (GRIT) was formed in 1989 by the Living Trust of Eleanor Pierce Stevens. During its term, it paid all of its income to Eleanor Pierce Stevens. The residue was distributed to the remainder beneficiary, E. Pierce Marshall, who was also executor of the Eleanor Pierce Stevens Estate. The GRIT received an indirect gift of stock through a transfer created by a below-fair-market-value sale of stock by her former husband, J. Howard Marshall, II, in 1995, for which no gift tax was paid. The United States brought suit against the Stevens Estate and its trustees to collect the unpaid gift tax.

The Stevens Estate contended that under the Kansas law applicable to the GRIT, Eleanor Pierce Stevens was the income beneficiary and the gift enhanced the corpus. Therefore, the transfer of value benefited

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the remainder beneficiary, E. Pierce Marshall, who should pay the gift tax.

The Court disagreed, stating that the gift taxes should have been paid from trust corpus when they were not paid by the donor. But because the trust had terminated, the donee was liable for the gift tax. Acknowledging that the question of the identifying whether the income beneficiary or the remainder beneficiary was subject to gift tax had not been addressed by the courts, the Court applied the tests developed by the Supreme Court for determining the identity of the donee eligible for a gift tax exclusion under I.R.C. §2503(b). It stated that it could see "no reason why the definition of a donee for a gift tax exclusion should differ from the definition of a donee for the purposes of gift tax liability." Following *Helvering v. Hutchins*, 312 U.S. 393 (1941), it reasoned first that individual beneficiaries are the donees of gifts to a trust. Then it cited the rulings in *Ryerson v. U.S.*, 312 U.S. 405, 61 S.Ct. 656 (1941) and *U.S. v. Belzer,* 312 U.S. 399, 61 S.Ct. 659 (1941) as authority for the principle that the gift tax exclusion is applicable to present gifts only. Extending this reasoning to the case at hand, it ruled that Eleanor Pierce Stevens, the income beneficiary, was the only donee of the gift. The remainder beneficiary should not be considered the donee because he held an uncertain interest that could have been depleted.

Wandry v. Commissioner, T.C. Memo. 2012-88; Nos. 10751-09, 10808-09 (26 Mar 2012)

The Tax Court ruled that a formula gift did not violate public policy and permitted a gift of a specific dollar amount using a formula that allowed for the adjustment of the number of shares gifted to a non-charitable entity in conformance with the subsequent IRS or Tax Court valuation of the gifted property.

In 1998, Joanne M. Wandry and her husband formed a Colorado limited family partnership (WFLP) and transferred cash and securities to it. They started a new business, Norseman Capital, LLC., in 2001 and transferred all of the WFLP assets to it. In 2004, they made gifts of shares of Norseman valued at $261,000 to each of their four children and $11,000 (the then-current per donee annual exclusion amount) to each of their five grandchildren. The number of shares gifted was based on the federal gift tax exemption in effect on the date of the gift, according to the following formula (the "adjustment clause"): the "number of gifted units shall be adjusted accordingly so that the value of the number of units gifted to each person equals the amount set forth above, in the same manner as a federal estate tax formula marital deduction amount would be adjusted for a valuation redetermination by the IRS and/or a court of law." Based on their valuations, Mrs. Wandry and her husband filed gift tax returns reporting to report their annual lifetime gift exclusion amounts of $1 million. The capital accounts of the donors and recipients were adjusted accordingly.

On audit, the IRS assigned each child's interest and each grandchild's interest a considerably higher valuation than the Wandrys had reported. Based on values stipulated by both parties, the IRS claimed that gift tax plus interest was owed because the completed gifts were in excess of the gift tax exclusion amount. It stated that the adjustment clause was a condition subsequent that did not reduce the value of the gift under Comm'r v. Proctor, 142 F.2d 824, 827-828 (4th Cir. 1944). It also claimed that the adjustment clause was contrary to public policy.

The Court rejected the IRS's argument that in adjusting the capital accounts to provide for the initial number of units transferred, the amount of the gift was thereby fixed by state law and could not be adjusted by a later revaluation. The Court held that capital accounts were not controlling and were, in any case, factually unclear.

The Court followed *Estate of Petter v. Commissioner*, T.C. Memo, 2009-280, aff'd 653 F.3d 1012 (9th Cir. 2011) in finding that the donor's intent was to transfer a fixed dollar amount of property, not to transfer a fixed percentage or amount of property whose dollar value would be subsequently readjusted. It stated that the only variable should be the finally determined value for the property that is to be transferred. Because a fixed dollar amount of property was transferred, the formula served only to adjust the number of units transferred.

The Court also rejected the argument presented by the IRS that permitting such dollar transfers was contrary to public policy. The Court noted that, although in Petter the Court cited the public policy of encouraging gifts to charitable organizations, that was not a "determinative" factor in its decision to accept the formula clause. Here, no charity was involved and the Court stated that the formula gift was effective in any case.

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2011-2012 IRS PRIORITY GUIDANCE PLAN UPDATE, 1/26/2012

The 2011-21012 Priority Guidance Plan was released in September, 2011. Of the original 17 guidance projects concerning gifts, estates and trusts, the following seven have been published:

6. Guidance under IRC § 1022 concerning estates of decedents who died in 2010. (Published as Rev. Proc 2011-41, 2011-35 IRB; Notice 2011-66, 2011-35 IRB and Notice 2011-76, 2011-40 IRB.)

7. Guidance on portability between spouses of the Unified Credit under IRC § 2010(c). (Published as Notice 2011-83, 2011-42 IRB.)

8. Treasury Regulations under IRC § 2032(a) regarding the imposition of restrictions on estate assets during the six-month alternate valuation period. (Published as Reg-11216-07 (NPRM).)

9. Final Treasury Regulations under IRC § 2036 regarding graduated GRATs. (Published as T.D. 9555, 11/08/2011.)

10. Revenue Ruling concerning whether a grantor's retention of a power to substitute trust assets in exchange for assets of equal value, held in a nonfiduciary capacity, will cause insurance policies held in the trust to be includible in the grantor's gross estate under IRC § 2042. (Published as Rev. Rul. 2011-28, 2011-49 IRB.)

12. Revenue procedure providing procedures for filing protective claims for refunds for amounts deductible under IRC § 2053. (Published as Rev. Proc 2011-48, 2011-42 IRB.) (See summary above.)

13. Notice on decanting of trusts under IRC § 2501 and IRC § 2601. (Published as Notice 2011-101-2011-52 IRB.) (See separate summary above.)