PHILADELPHIA BAR ASSOCIATION

Probate and Trust Law Section Newsletter

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Report of the Chair

By ROBERT H. LOUIS
SAUL EWING LLP

I hope you have been able to participate in the educational programs at the quarterly meetings of the Section. These programs are a highlight of the activities of the Section. We still have one event planned for the year -- our renowned annual meeting and holiday party, a chance to mingle with our colleagues and members of the judiciary and celebrate a year of achievement.

Our Section will be a co-sponsor of a special educational program on how to work with diverse clients. This program is scheduled for November 30, and we will circulate more information about it as the date approaches. A group within our Section has been working on a diversity policy for the Section, to encourage broader participation in our work, and we expect to publicize that shortly. In addition, as part of our service to the Philadelphia community, we have made grants to the Senior Law Center and Philadelphia VIP to help with training lawyers and interns who can participate in the work of those organizations as it relates to probate and trust law matters.

Our various committees continue to follow an active schedule of programs, and I encourage you to join one or more of those committees. The committees and contact information are listed in another section of this newsletter.

Inside this Issue...

HOW MANY APPRAISERS DOES IT TAKE TO VALUE STOCK FOR A BUY-SELL AGREEMENT ?

By JOHN E. HEMPSTEAD, ASA, CFA
MANAGING DIRECTOR
HEMPSTEAD & CO. INC.

Shareholder buy-sell agreements can employ a number of methods to determine the transaction price to be used when a shareholder sells his interest in a privately-held company. A sale transaction can be made necessary by a variety of triggering events, such as the death of a shareholder, retirement or other termination of employment by a shareholder or bankruptcy or divorce of a shareholder.

Determining Transaction Price

The provisions for establishing a transaction price commonly found in buy-sell agreements include the following:

- A fixed price ($10 a share, for example)
- A formula price (1.2 times book value, or six times earnings, for example)
- A price determined by an appraiser or appraisers.

The fixed price approach, notwithstanding its simplicity, has the obvious shortcoming that with the passage of time, the fixed price specified will come to be less and less representative of the true value of the stock. And when that happens, someone gets shortchanged in the buyout. Many fixed-price buyout formulas have a provision for periodic updates of the buyout price. In our experience, such updates are seldom carried out.

A formula price has the advantage, in theory at least, that it self-adjusts as time passes. For instance, under a multiple of book value formula, if book value doubles, the buyout price doubles. This provides for at least a rough alignment of formula price to actual value.

What a formula price leaves out, however, is the application of judgment and common sense to the valuation process. For example, a company may have accumulated a large amount of excess cash over a period of time. If its buyout price were to be based on a formula that looked solely at earnings, the excess cash would be left out of the picture. Somebody would be shortchanged.

Using an Appraiser

For these reasons, buy-sell agreements often provide for the use of an appraiser to determine the buy-sell price. There are a variety of ground rules employed for using appraisers. One approach is to have buyer and seller agree on an appraiser, and to have him/her perform the appraisal. Another approach is to have each side appoint an appraiser, have each appraiser perform an appraisal, and then average the two numbers.

It's not uncommon to employ three appraisers, utilizing a third (neutral) appraiser to reconcile the work of the first two. The reconciliation can be done several ways. The parties can simply average the three appraisals. Or the third appraiser can review the work of the first two and select the one he thinks is most reasonable. Or the three appraisers can all calculate values, and the two closest to each other can then be averaged to produce the final result. This is a way to reduce the effect of outliers.

A Modest Proposal

These multi-appraiser approaches are expensive and time-consuming. When we are asked for our thoughts on how to use appraisers in the buy-sell process, here is what we usually recommend. We suggest that the parties select a single appraiser at the time the buy-sell agreement is initially drafted. The appraiser prepares an appraisal at that time, periodically thereafter, and at the time of a triggering event. There are several advantages to this approach:

- The parties see the appraisal, how it is performed, and the result. They have a chance to iron out problems with the valuation assumptions, or with the appraiser himself.

- The potential for shock and surprise at the appraised number is reduced, or at a minimum, the parties have an opportunity to get used to it.

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JOIN A COMMITTEE

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

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Appraisers, continued from Page 2

- The parties have a valuation number at all times, which can be useful for a variety of purposes, such as estate planning, or for awarding stock-based compensation.

- It's less expensive to have a process that involves only one appraiser rather than two, or three.

When parties are entering into a corporate buy-sell agreement, they would be well advised to consult with an appraiser during the drafting process. Doing so might help avoid some pain and suffering down the road.

CASE SUMMARIES FROM THE ORPHANS' COURT LITIGATION COMMITTEE

Griggs Estate (No. 2), 2 Fid. Rep. 3d 354 (O.C. Chester 2012)

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

Section 5610 of the Probate, Estates and Fiduciaries Code (20 Pa. C.S. §5610) provides that an "agent shall file an account of his administration whenever directed to do so by the Court and may file an account at any other time." However, Section 5610 does not address who may petition the Court to compel an agent under a power of attorney to file an account. Quite clearly the principal has standing to compel the filing of an account, but what if the principal has passed away? Pennsylvania courts have not been consistent on this issue. In *Griggs Estate (No. 2)*, 2 Fid. Rep. 3d 354 (O.C. Chester 2012) the widow of the decedent filed a petition to compel the decedent's agent under a power of attorney to file an account of her actions. The widow, who was married to the decedent for 52 years, alleged that the undue influence of decedent's agent/neighbor led the decedent to execute a power of attorney and a revocable trust, with the power of attorney naming the agent, and the revocable trust, unsurprisingly, benefitting the agent. The agent filed preliminary objections on the basis that the widow did not have standing to compel the agent to file an account.

The Orphans' Court sustained the objection and dismissed the widow's petition. In reaching its holding, the Court noted that "any inquiry into the alleged misuse of a power of attorney is to be made by the person who granted the power, or by the executor of his estate, and not by a beneficiary whose interest was hurt by its exercise." *Griggs,* 2 Fid. Rep. 3d at 355, citing *Golub Trust*, 27 Fid. Rep. 2d 260, 265 (O.C. Philadelphia Co. 2006).

The *Griggs* Court relied in large part on two cases, *Rosewater Estate*, 25 Fid. Rep. 2d 83 (O.C. Mont. 2005) and *Kilpatrick's Estate,* 368 Pa. 399 (1951). In *Rosewater*, the stepsons of the decedent, who were remainder beneficiaries of a marital trust created by the decedent's spouse, who predeceased the decedent, sought to challenge the actions of the decedent's agents, who, with the purported consent of the decedent, withdrew all of the assets of the marital trust and distributed those assets to the decedent (thereby stripping the stepsons of their inheritance as remainder beneficiaries of the marital trust). In sustaining the agents' preliminary objections due to lack of standing, the Orphans' Court held that only the decedent's executors (who were also the agents) could challenge the agents' actions. Despite their status as remainder beneficiaries of the marital trust, the Court emphasized that any surcharge which might arise out of the agents' alleged wrongdoing "would benefit [decedent's] estate, not [decedent's predeceased wife's] marital trust nor [the stepsons. The stepsons] lack a 'substantial, direct and immediate' interest in any dispute over whether the agents acted appropriately by directing the withdrawal of these funds[.]" *Rosewater,* 25 Fid. Rep. 2d at 85 (citations omitted).

In *Kilpatrick*, the decedent's second husband (who was also the beneficiary of the decedent's estate) sought to compel the Orphans' Court to review the account filed for the estate of the decedent's first husband on the basis that the accountant for the first husband's estate did not properly account for all of the assets in the estate (and therefore not all of the assets of the first husband's estate passed to the decedent's estate). The Supreme Court noted that if the second husband's claims were true, then the decedent's estate would be increased; however, the Court held that the decedent's second husband was not a party in interest to the first husband's estate, and that only the executor of the decedent's estate had standing to pursue the matter. *Kilpatrick*, 84 A.2d at 340.

Based on the foregoing, the Orphans' Court in *Griggs* sustained the preliminary objections and dismissed the widow's petition to file the account.

Although not addressed in *Griggs*, other courts have concluded that a beneficiary of a decedent's estate does have standing to challenge the conduct of the decedent's agent under a power of attorney. In *Haskins et al. v. Carroll et al.,* 25 Fid. Rep. 2d 361 (O.C. Bradford

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Case Summary, continued

2005), beneficiaries of an estate filed a petition to compel the agent under the decedent's power of attorney to file an account of her actions as agent, and the agent filed preliminary objections alleging that the beneficiaries lacked standing to do so. The Court relied on *Appeal of Beilier*, 144 Pa. 273 (1891), which provided that a party in interest has the right to compel the filing of an account (in that case, the decedent's creditor had standing to compel the executor to file an account). The Court concluded that the beneficiaries of the decedent's estate were parties in interest "because they have an interest in the estate, and they will benefit from the will. As a result, they can demand an accounting." *Haskins*, 25 Fid. Rep. 2d at 363. Accordingly, the Court dismissed the agent's preliminary objections.

The law of standing allows the courts to play an important gatekeeper role and prevents the system from becoming unduly clogged with cases brought by those with minimal, if any, legally recognizable interests in a matter. In the important legal realm of agents under powers of attorney, however, where we often encounter instances of agents who serve as agents under a power of attorney, executors of the estate, and as beneficiaries of the estate, the slavish application of traditional standing rules may prevent justice from being served, because a wrongdoer will seldom seek to compel him or herself to file an account. Practitioners representing both agents and beneficiaries should be wary when advising clients in this regard.

Practice Points

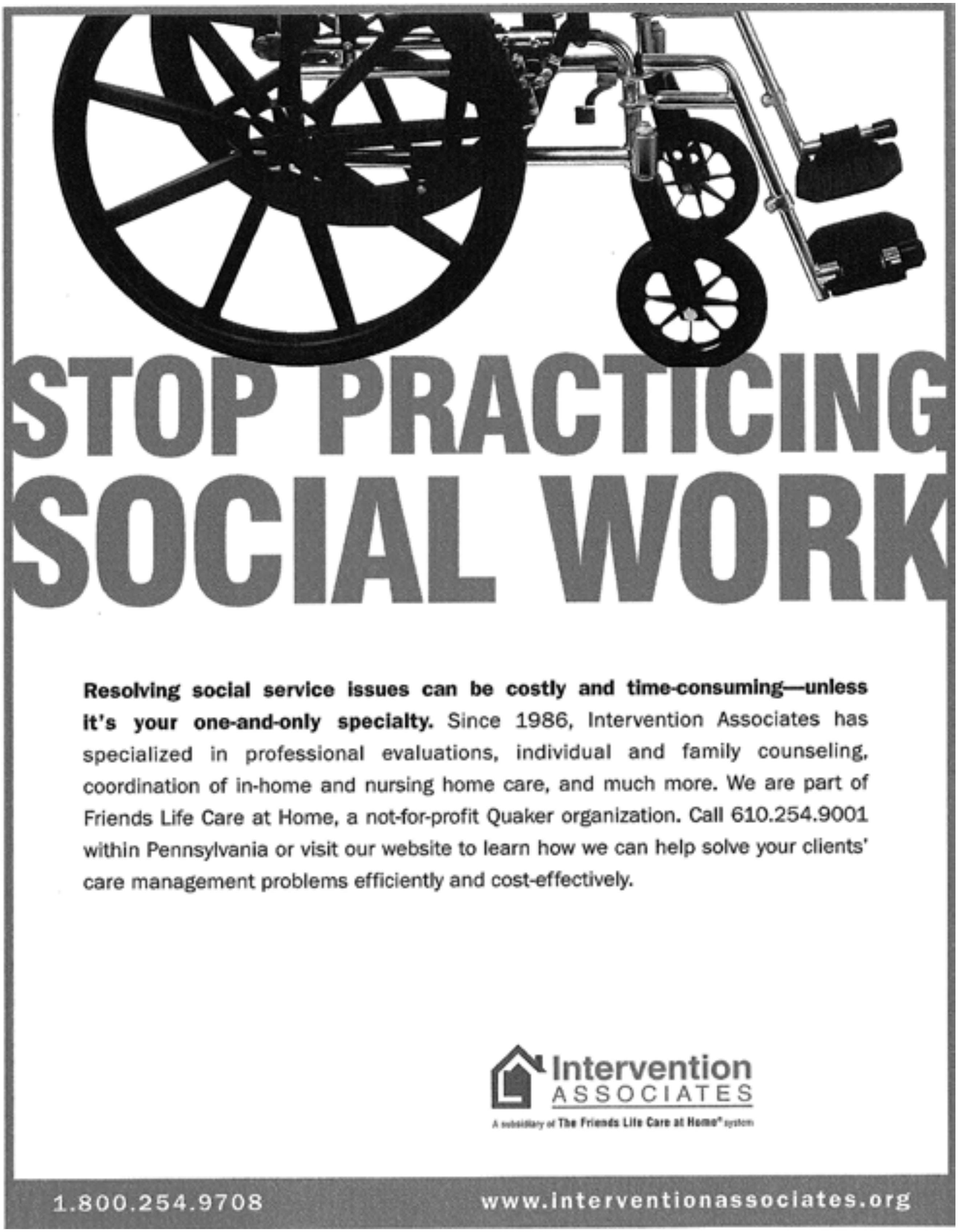
By BERNICE J. KOPLIN
SCHACHTEL, GERSTLEY, LEVINE & KOPLIN, P.C.

Two unrelated practice points, one in connection with Pennsylvania Inheritance Tax, the other with amending the U.S. Income Tax Return for Estates and Trusts (Form 1041):

How do you notify the PADR that a client terminated your services as an attorney after probate, when the attorney is of record with the Register of Wills office? Generally, the attorney should write a letter to that effect to the Register of Wills. Nevertheless, the PADR does not receive this information because there is no procedure for routinely transmitting it from the Register of Wills office to the PADR. Neither is there a form which the attorney can provide to the PADR for its records reflecting that the attorney is no longer representing a specific estate. This has become important recently because the PADR has increased its efforts to contact personal representatives and attorneys responsible for estates in delinquent status to cause them to settle the estates with the PADR by filing the returns and paying the tax due. I discussed this with one of the collection agents recently, and he advised that the only procedure for notifying the PADR that the attorney is no longer responsible is to wait to be contacted by a collection agent and then tell him that this is the situation, because there is no procedure available for routine advance notification.

How do you amend a fiduciary income tax return (Form 1041X) when an initial return was accepted and the refund already received by an estate or trust? By way of example, this could occur when additional expenses are discovered after the return and first refund, which were substantial enough to justify the filing of an amended return. This should not occur often, but when it does, a recommended way to prepare the amended return is to asterisk the line entitled Payments, and type at the bottom Statement attached explaining why additional refund is due, and attach the first page of the accepted return with a brief explanation. Additional deductions would be increased, the payments would reflect the net amount of tax paid after the first refund, and the result would be the additional refund due. Presumably this would all occur prior to the expiration of any applicable statute of limitations.

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.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ETHICS COLUMN

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

What ethical considerations are involved when a lawyer drafts a Will or Trust in which he or she or a colleague in the firm is named as a fiduciary?

Some lawyers customarily recommend themselves as fiduciaries to their clients. This scribe is not among them. In my opinion, doing so is usually unnecessary and inappropriate. Family members, trusted friends and corporate fiduciaries should usually be chosen for that purpose. Furthermore, I am not anxious to undertake that future responsibility. Only on those rare instances where such prospects do not exist or I am perceived as a possible informal argument settler when children are involved have I consented to serve. However, it should be emphasized that the Pennsylvania Rules of Professional Conduct specifically envision the possibility that the lawyer may name himself or herself as a fiduciary in a document he or she prepares. Comment 8 to Rule 1.8 provides as follows:

> [8]. "This Rule does not prohibit a lawyer from seeking to have the lawyer or a partner or associate of the lawyer named as executor of the client's estate or to another potentially lucrative fiduciary position. Nevertheless, such appointments will be subject to the general conflict of interest provision in Rule 1.7 when there is a significant risk that the lawyer's interested in obtaining the appointment will materially limit the lawyer's independent professional judgment in advising the client concerning the choice of an executor or other fiduciary. In obtaining the client's informed consent to the conflict, the lawyer should advise the client concerning the nature and extent of the lawyer's financial interest in the appointment, as well as the availability of alternative candidates for the position."

The Commentaries to Rule 1.7 prepared by The American College of Trust and Estate Counsel (ACTEC Commentaries on the Model Rules of Professional Conduct, 4th Ed., 2006) state: "A lawyer should be free to prepare a document that appoints the lawyer to a fiduciary office so long as the client is properly informed, the appointment does not violate the conflict of interest rule of MRPC 1.7, and the appointment is not the product of undue influence or improper solicitation by the lawyer".

The American Bar Association issued a formal ethics opinion in 2002 that allows the practice. The opinion reads in part as follows: "One of the lawyer's important responsibilities in providing estate planning for his client is to help her select an appropriate personal representative to administer her estate and a trustee to manage any trust established by the Will. The lawyer is required by Rule 1.4(b) to discuss frankly with the client her options in selecting an individual to serve as a fiduciary…. When exploring the options with his client, the lawyer may disclose his own availability to serve as a fiduciary. The lawyer must not, however, allow his potential self-interest to interfere with his exercise of independent professional judgment in recommending to the client the best choices for fiduciaries. When there is a significant risk that the lawyer's independent professional judgment in advising the client in the selection of a fiduciary will be materially limited because of the potential amount of the fiduciary compensation or other factors, the lawyer must obtain the client's informed consent and confirm it in writing. When the client is considering the appointment of a lawyer as fiduciary, the lawyer must inform the client that the lawyer will receive compensation for serving as fiduciary, whether the amount is subject to statutory limits or court approval, and how the compensation will be calculated and approved…. The lawyer should discuss with the client the fact that the lawyer, acting as fiduciary, may select himself or his firm to serve as the lawyer for the trust or estate, with the result that additional fees may be received by the lawyer." ABA Formal Opinion 02-426 (2002).

Because of the high probability that the lawyer will benefit both from the commission received

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TAX UPDATE

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

FEDERAL ESTATE TAX
GROSS ESTATE INCLUSION

Estate of Morgens v. Commissioner, No. 10-73698, 2012 WL 1548087 (9th Cir., May 3, 2012)

The Ninth Circuit held that the gift tax paid by the trustees of a QTIP trust relinquished by a surviving spouse was includible in her gross estate under IRC § 2035(b) because the gift taxes were paid within three years of her death.

Mr. and Mrs. Morgens executed a joint revocable trust. Upon Mr. Morgens' death, the trust was divided into two separate trusts: a survivor's trust representing Mrs. Morgens' one-half share of the couple's community property in the revocable trust and a QTIP trust representing Mr. Morgens' one-half share of the couple's community property in the revocable trust. Under the terms of the QTIP trust, Mrs. Morgens was entitled to receive the net income of the trust and distributions for health, support and maintenance. Upon her death, the remaining assets in the QTIP trust were to be distributed to her children. Mr. Morgens' estate claimed an estate tax marital deduction for the share passing to the QTIP trust.

In late 2000 and early 2001, Mrs. Morgens transferred her income interest in the QTIP trust to her children, in return for an indemnification agreement in which she was indemnified for any gift or estate taxes imposed as a result of these transfers. These transfers to the children were

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Ethics Column, continued

as a fiduciary and will be able to retain himself or his or her firm as counsel, there will almost always be an actual or perceived potential self-interest that could well interfere with the lawyer's exercise of independent professional judgment in recommending to the client himself or herself as a fiduciary. Thus, it would seem wise to obtain the client's informed consent in writing pursuant to Rule 1.0 in all cases.

The lawyer, at minimum, should discuss with the client: (1) the range of potential fiduciaries available and the pros and cons of each, (2) the probable commission, or lack thereof, depending on the fiduciary selected, (3) the lawyer's right to charge a commission, if selected, and the basis on which his or her commission would be calculated, (4) the lawyer's right, as the fiduciary, to select himself or his law firm as counsel and that he or she could benefit financially even more by that arrangement, and, finally, (5) the need to specify why the client has chosen the lawyer as the fiduciary rather than other prospects. The discussion should be confirmed by the lawyer in a letter which should alert the client to the possibility of having independent counsel review the letter and provide an opinion about the arrangement. The lawyer should ask the client to sign and return the letter, which the lawyer should place with the Will after making a copy to retain in the client's file.

This issue was featured in a recent meeting of ACTEC's Professional Responsibilities Committee. Christopher H. Gadsden, an ACTEC Fellow from Pennsylvania who chairs the Committee, shares this scribe's reluctance to serve as a fiduciary and William T. Hennessey, a Florida Fellow, who led the discussion and provided interesting materials, suggested that many lawyers seem unaware of the importance of being cautious about naming themselves and unaware of the need to obtain written consent from the client when they do.

WHAT WOULD YOU LIKE TO SEE IN FUTURE ETHICS COLUMNS?

Send your questions and ideas to:

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Tax Update, continued

net gifts: the trustees of the QTIP trust paid the gift taxes associated with the transfers and filed gift tax returns for both years to report the gifts of the income interest and the deemed gifts of the remainder interest in the trust under IRC § 2519.

After Mrs. Morgens' death in 2002, her executors did not include in her gross estate the gift taxes paid by the trustees of the QTIP trust with respect to the 2000 and 2001 transfers because they claimed that, under IRC § 2035(b) she and her spouse had not paid them within three years of her death. The IRS audited and issued a notice of deficiency for the amount of the gift taxes.

The Estate argued that IRC § 2207A(b), and not IRC § 2035(b), applies to the gift taxes paid by the trustees of the residual trust. IRC § 2207A(b) provides that a surviving spouse may recover from the recipients of a QTIP the gift taxes paid on the deemed transfer of QTIP assets. IRC § 2035(b) provides that the gross estate includes any gift tax paid by the decedent or decedent's estate on any gift made by the decedent or spouse in the three years preceding the decedent's death. The IRS argued that Mrs. Morgens was liable for the gift tax on those transfers and that IRC § 2207A(b) does not shift her personal liability to the trustees of the QTIP trust.

The Court ruled in favor of the IRS, reasoning that under IRC § 2044 and IRC § 2519 the surviving spouse who benefits from a marital deduction at the death of the first spouse is treated as if he or she were the outright owner of the QTIP. Thus Mrs. Morgens was deemed to have been the donor of the income and remainder interests in the QTIP trust and bears the gift tax liability associated with the transfer of those interests. The Court also stated that IRC § 2207A(b) does not place the liability for gift taxes paid as a result of the deemed transfer under IRC § 2519 on the recipients of the income interest, although it agreed with the Estate that the recipients bear the ultimate financial burden for the gift taxes due. It stated that IRC § 2207A(b) therefore gives the Estate the right to recover the gift taxes from the recipients.

The Court cited *Estate of Sachs*, 88 TC 769 (1987), aff'd in part and rev'd in part on another ground 62 AFTR 2d 88-6000, 856 F2d 1158, 88-2 USTC 13781 (CA-8, 1988) as precedent in holding that the phrase "gift tax paid by the decedent or his estate" in IRC § 2035(b) includes the gift tax attributable to net gifts made by a decedent during the three-year period prior to his or her death, even if the donees were obligated by contract to pay the gift taxes or indemnify the donor for gift tax liability. The gift taxes paid as a result of Mrs. Morgens' deemed transfer of the QTIP trust were therefore includible in her gross estate.

MARITAL DEDUCTION

Windsor v. U.S., 109 AFTR 2d ¶ 2012-870 (DC N.Y. 6/6/2012)

The District Court for the Southern District of New York ruled that the estate tax marital deduction is available to same-sex couples.

After registering as domestic partners in New York City in 1993, Edith Windsor and Thea Spyer married in Canada in 2007. They were considered married by the state of New York. Spyer died in 2009 and left all of her assets to Windsor. Spyer's estate sought a refund of the federal estate tax of $363,000, representing the amount of the estate tax marital deduction denied to it, and a declaration that Section Three of the Defense of Marriage Act, 1 U.S.C. § 7 (DOMA), which defines marriage for all federal purposes as a legal union between one man and one woman, violates the Equal Protection Clause of the Fifth Amendment. The District Court ruled in favor of the estate and declared that Section Three of DOMA is unconstitutional as applied to it because it unconstitutionally discriminates against married same-sex couples.

LATE ELECTION OUT OF ESTATE TAX

PLRs 1238011, 1238012 and 1238016 (issued September 22, 2012)

The IRS issued three rulings allowing for a late election out of the 2010 estate tax. The rulings allowed an extension of 120 days from the date of the letters to file Form 8939, Allocation of Increase in Basis for Property Acquired from a Decedent, to make the Section 1022 Election and to allocate basis to eligible property transferred as a result of Decedent's death.

IRS FORM 706

The IRS released a draft of the new form 706, United States Estate and Generation-Skipping Transfer Tax Return, to be used for estates of decedents dying after 12/31/2011 and before 1/1/2013. See http://www.irs.gov/pub/irs-dft/f706--dft.pdf. The draft form contains a new Part 6, "Portability of Deceased Spousal Unused Exclusion," which includes a "Denial of Portability" check box, and a new Schedule PC, "Protective Claim for Refund." The latter incorporates the provisions of

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Tax Update, continued

Rev. Proc. 2011-48.

On September 18, 2012, the IRS released draft instructions to accompany draft Form 706. The instructions are found at http://www.irs.gov/pub/irs-dft/i706--dft.pdf. Instructions for calculating the DSUE amount that can be transferred to a surviving spouse are found in Part 6, Section C; DSUE amounts received from predeceased spouses are calculated according to the instructions in Part 6, Section D. Line 9 of Part 2, the tax computation, now includes a computation for the applicable exclusion amount and credit amount that takes into account the DSUE amount received from a predeceased spouse.

Estates filing Form 706 solely to elect portability do not have to report the value of property qualifying for the marital or charitable deduction. Such estates are allowed to simply check a box in Part 1, Line 11, report the assets (but no valuation) on the appropriate schedule and, for total estate assets up to $1,000,000, provide an estimate of the total value of the estate assets, rounded to the next highest $250,000. However, under certain circumstances, which include a partial QTIP election, executors cannot use this special rule.

The new Schedule PC, "Protective Claim for Refund," is filed to preserve the right of the estate to claim a refund based on the amount of an unresolved claim or expense that may not become deductible under IRC § 2053 until the limitation period has ended. Schedule PC must be filed, in duplicate, with Form 706, and each separate claim or expense must be filed on its own Schedule PC. Such expenses should be reported on Schedule J, K or L as appropriate, but without a value. Related attorney and accounting fees do not have to be identified or substantiated on the Schedule PC. The estate will receive an acknowledgement of receipt from the IRS for the first Schedule PC, which serves as the initial notice of protective claim for refund. The estate should notify the IRS within 90 days from the date when each claim is resolved or becomes certain. Such notification consists of either filing a supplemental Form 706 with an updated Schedule PC or filing an updated Form 843.

FEDERAL GIFT TAX

Wimmer v. Commissioner, T.C. Memo. 2012-157, No. 26540-07 (June 4, 2012)

The Tax Court ruled that gifts of limited partnership interests generating regular distributions of income qualify for the gift tax annual exclusion.

The Court held that gifts of limited partnership interests made in 1996-2000 by the George Wimmer Family Partnership (FLP) qualified for the federal gift tax annual exclusion. Mr. and Mrs. Wimmer formed the FLP through their respective revocable trusts and funded it with publicly traded, dividend-paying stocks. The FLP agreement required pro rata distributions to the partners. During the period in question the FLP made annual exclusion gifts of FLP interests to the Wimmers' children and a trust for their grandchildren and made pro rata distributions to the partners using the dividends received from its stocks. The grandchildren's interests were made available to them through Crummey withdrawal powers. The issue in this case was therefore whether the Crummey powers would qualify the gifts of FLP interests to the grandchildren's trust for the gift tax annual exclusion. That issue depends on whether the gifts qualified as present interest gifts under IRC § 2503(b).

In making its decision, the Tax Court examined the partnership agreement to see whether it contained restrictions on the donees' rights to use, possess or enjoy the partnership interests or the income from the partnership. The Court recognized that the transfer restrictions in the partnership agreement limited the donees' rights to use their partnership interests, but it also determined that the donees' rights to income from the partnership were not restricted.

The gifts were held to represent a present interest in the gifted property and thus qualify for the gift tax annual exclusion for the following reasons: (1) The FLP was expected to generate income. It held only publicly traded, dividend-paying stock that received quarterly dividends. (2) A portion of this income was expected to flow consistently to the donees. The only asset of the grandchildren's trust was the FLP interest. The partnership agreement called for distributions of partnership income to the trust, which in turn would flow to the trust beneficiaries. (3) The income was readily ascertainable. The trust held only publicly traded stock that had a history of yielding dividends.

INTEREST ON GIFT TAX LIABILITY

U.S. v. MacIntyre, 2012 U.S. Dist. Lexis 42487 (S.D. Tex.) (June 7, 2012)

The District Court ruled that when gift tax is not paid by the donor, the income beneficiary's liability for gift taxes was not capped by the value of the gift.

In 1995 the IRS assessed gift taxes against the estate of J. Howard Marshall for indirect gifts

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Tax Update, continued

of shares of MPI to other shareholders. The Marshall estate did not fully pay the gift taxes and in 2008, pursuant to IRC § 6234(b), the IRS assessed the gift tax liability against the estate of one of the donees, Eleanor Stevens, (who was once J. Howard Marshall's wife). The Stevens estate paid the gift tax principal but contested the assessment of interest on the unpaid gift tax liability. The Court determined that it had the authority under IRC § 6234(b) to assess interest on the Stevens estate for the unpaid liability, even if such interest liability was outside the cap on total liability that was determined by the value of the gift received. The Court reasoned that under IRC § 6234(b) the gift tax obligation is limited at the time it passes from the donor to the donee, but that an unlimited amount of interest can accrue to the gift tax owed by the donee thereafter.

The Court noted a substantial circuit split on this matter.

IRS FORM 709

On September 18, 2012, the IRS posted draft 2012 "United States Gift (and Generation-Skipping Transfer Tax Return at http://www.irs.gov/pub/irs-dft/f709--dft.pdf. The new form contains new Part I, Line 19, asking "Have you applied a DSUE amount received from a predeceased spouse to a gift or gifts reported on this or a previous Form 709?" If the answer is "yes," a box should be checked and a new Schedule C (the DSUE amount) must be completed.

Schedule C is used to compute the DSUE amount(s) received from the last deceased spouse and any other predeceased spouse(s). The tax computation on Line 7, Part 2 factors in these DSUE amounts.

TAX IMPLICATIONS OF MODIFICATION OF IRREVOCABLE TRUST

Private Letter Ruling 201233008 (August 17, 2012)

The IRS ruled that the modification of an irrevocable trust under state law, made with the consent of the settlor and all beneficiaries, will not cause federal estate tax inclusion. It reasoned that IRC § 2036 did not apply because the settlor did not retain possession or enjoyment of the trust property, and IRC § 2038 did not apply since the settlor held a power that could only be exercised with the consent of all parties with an interest in the transferred property and all beneficiaries consented to the modifications.

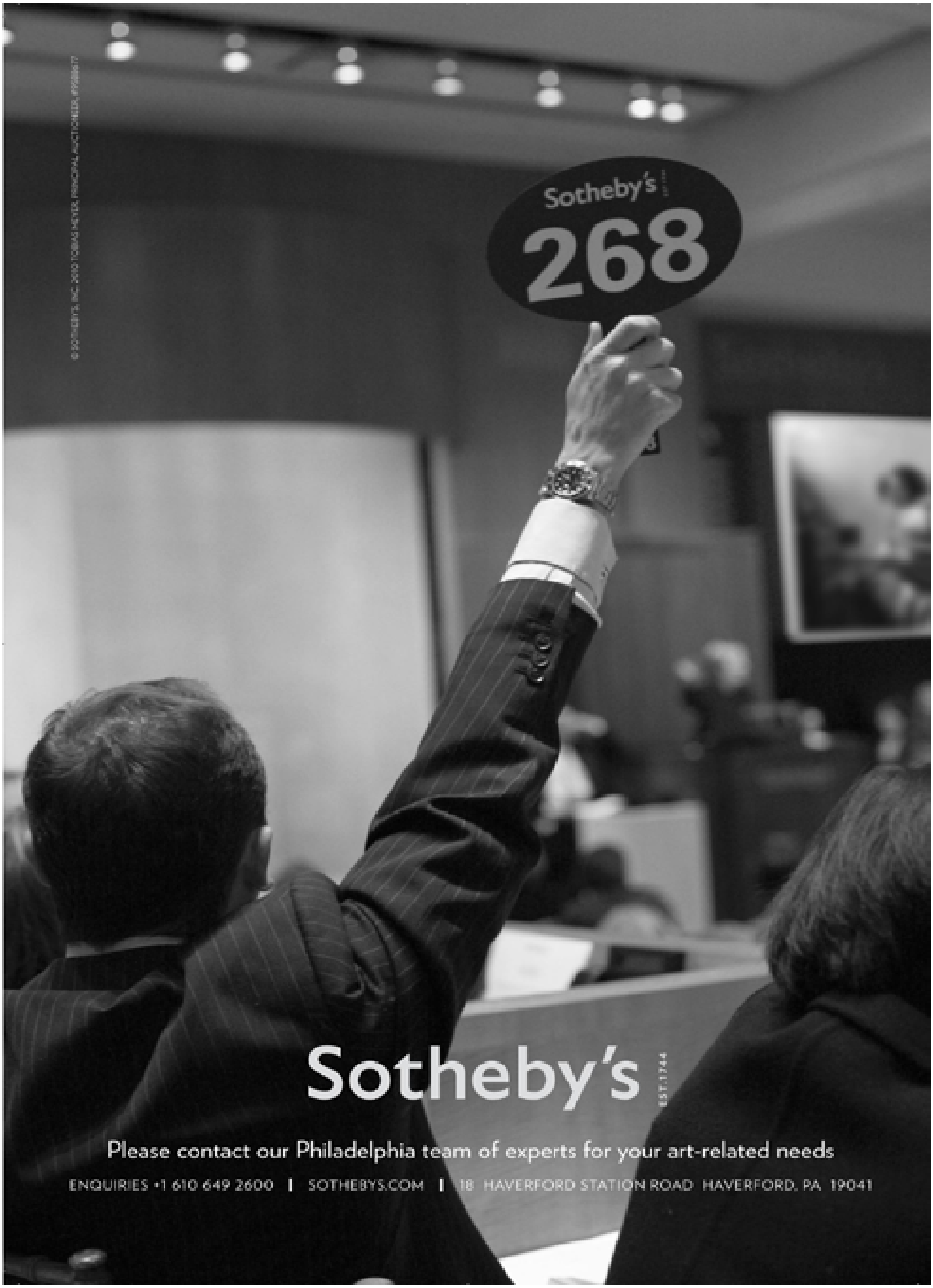
The IRS also ruled that such modifications did not result in federal gift tax liability to the settlor for two reasons. First, the original gift was a completed gift; and secondly since the agreement of all of the beneficiaries was required, the donor did not have a power under Treas. Reg. § 25.2511-2(e) to modify the trust that was exercisable by him in conjunction with a person not having a substantial adverse interest in the disposition of the transferred property or its income.

The IRS ruled that the modifications to the trust did not jeopardize the exempt GSTT status of the trust, to which the settlor had allocated his GSTT exemption. Applying the regulations concerning the exempt status of a modified "grandfathered" GSTT trust, Treas. Reg. § 26.2601-1(b), the IRS reasoned that the modified trust would retain its exempt GSTT status because modifications did not involve the shift in a beneficial interest in the trust to a person of a lower generation and the time for the vesting of any beneficial interest was not extended.

PENNSYLVANIA INHERTANCE TAX

Himmelberger v. Commonwealth of Pennsylvania, No. 1453 C.D. 2011 (May 10, 2012)

The Executrix of the estate of a Bucks County decedent who had entered into a New Jersey Civil Union three years before her death appealed the lower courts' determination that Pennsylvania Inheritance Tax was due on the value of the assets received by the civil union partner at the rate of fifteen percent. The Commonwealth Court affirmed the lower court's ruling without further discussion, but cited Section 1704 of the Marriage Law, 23 Pa. C.S. Section 1704, in a footnote ("It is hereby declared to be the strong and longstanding public policy of this Commonwealth that marriage shall between [sic] one man and one woman. A marriage between persons of the same sex which was entered into in another state or foreign jurisdiction, even if valid where entered into, shall be void in this Commonwealth)."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A Judicial History of the Orphans' Court Division

Philadelphians can take pride in the fact that Orphans' Courts have been held in this City since 1683. They can further take pride in the able and distinguished jurists who have sat as Judges of those Courts. The current Judges of this Division continue a long and illustrious tradition.

King Charles II granted the province of Pennsylvania to William Penn by Royal Charter dated March 4, 1681. William Penn came to Pennsylvania in October of 1682 and called a General Assembly. See Section 1, pages 11-12 of The Pennsylvania Manual, Volume 112 (December, 1995). Sitting at Chester, on December 7, 1682, the first General Assembly of the Province of Pennsylvania enacted the 77th Law which provided that the justices of each County Court should sit, "....to inspect and take care of the estates, usage, and employment of orphans, which shall be called the Orphans' Court * * * That care may be taken for those, that are not able to take care for themselves." See Opinion by Trimble, P.J., in Harton's Estate (No. 2), 86 P.L.J. 18, at page 21 (1938). "It is probable, that both the name and jurisdiction of this court were borrowed from the Court of Orphans of the city of London, which had the care and guardianship of children of deceased citizens of London, in their minority, and could compel executors to file inventories, and give security for their estates." See Opinion by Justice Sergeant in the matter of Wimmer's Appeal, 1 Wh. 95, 101 (1835).

The Orphans' Court of Philadelphia County was organized as a separate court of record under the Constitution of 1874, on January 4, 1875, and consisted of three judges. Three more judges were added, one each, in 1887, 1907 and 1927. Judge Allen M. Stearne and Judge Grover C. Ladner rose to become Justices of the Supreme Court of Pennsylvania. Judge Charles Klein was appointed to the Court on December 24, 1934, and, became President Judge on January 14, 1952. Judge Klein served as the last President Judge of the Orphans' Court of Philadelphia County, and, the first Administrative Judge of the Orphans' Court Division of the Court of Common Pleas of Philadelphia County. By constitutional amendment, effective January 1, 1969, the separate Orphans' Court of Philadelphia County was abolished and became the Orphans' Court Division of the Court of Common Pleas of Philadelphia County.

From January 4, 1875 to January 1, 1969, the following Judges sat on the Orphans' Court of Philadelphia County:

William B. Hanna
Dennis W. O'Brien
T. Bradford Dwight
William N. Ashman
Clement B. Penrose
Joseph C. Ferguson
Morris Dallett
Joseph F. Lamorelle
Edward A. Anderson
Charles Francis Gummey
John Marshall Gest
George Henderson
Henry C. Thompson, Jr.
Lewis H. Van Dusen
Allen M. Stearne
Charles Sinkler
Charles Klein
Curtis Bok
Robert V. Bolger
Grover C. Ladner
David G. Hunter
John P. Boland
Mark E. Lefever
Harold D. Saylor
Kendall H. Shoyer
Joseph D. Burke

On January 1, 1969, the Orphans' Court of Philadelphia became a division of the Philadelphia Court of Common Pleas. Since the merger, the following Judges have sat in the Orphans' Court Division of the Philadelphia Court of Common Pleas:

Charles Klein
Robert V. Bolger
Mark E. Lefever
Harold D. Saylor
Kendall H. Shoyer
Joseph D. Burke
Edmund S. Pawelec
Paul Silverstein
Theodore S. Gutowicz
Joseph C. Bruno
Judith Jamison
Alex Bonavitacola
Theodore A. McKee
Kathryn S. Lewis
Frank X. O'Brien
Levan Gordon
Petrese B. Tucker
Anne E. Lazarus
Joseph D. O'Keefe
Lynn B. Hamlin
John W. Herron
Matthew D. Carrafiello

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A History of the Orphans' Court Division, continued

The history of the position of Administrative Judge of the Orphans' Court Division is as follows:

Judge Edmund S. Pawelec January 5, 1976 - July 1, 1992
Judge Kathryn S. Lewis July 1, 1992 - April 1, 1996
Judge Petrese B. Tucker April 1, 1996 - July 14, 2000
Judge Alex Bonavitacola* July 14, 2000 - December 22, 2000
Judge Joseph D. O'Keefe December 22, 2000 - Present

*Judge Bonavitacola, as President Judge of the Philadelphia Court of Common Pleas, assumed a "Supervisory" role over the Orphans' Court until Judge O'Keefe was named as successor to Judge Tucker.

NEWSLETTER ARTICLES

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

David A. Ruben
email: david.a.ruben@ubs.com

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

Holiday Celebration
December 3, 2012
5:30 – 7:30 p.m.
The Down Town Club
150 S. Independence Mall West, Suite 1100, Philadelphia, PA

January Luncheon Program
January 22, 2013
11:45 a.m. - 1:45 p.m.
The Union League
140 S. Broad Street, Philadelphia, PA
Topic: "Anticipating Tomorrow: A Symposium on Emerging Legal Issues in the Life Insurance Industry"

February Luncheon Program
February 19, 2013
11:45 a.m. - 1:45 p.m.
The Union League
140 S. Broad Street, Philadelphia, PA
Topic: "Minimizing State Income Taxes on Trusts"
Speaker: Richard W. Nenno

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