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REPORT OF THE CHAIR

BY SUSAN G. COLLINGS | DRINKER BIDDLE & REATH LLP

As you will no doubt notice, our Newsletter has gotten a facelift. This change comes with the passing of the baton from David Ruben, who has so ably chaired the Publications Committee since 2009, to Heike Sullivan. With the help of a cadre of committee members, John Latourette, Melinda Rath and Bob Louis, David has consistently produced an informative publication that has addressed a wide variety of topics relevant to our Section members. We thank David for all of his hard work over the years as chair of the Publications Committee and wish him well as he moves from the Philadelphia area to Florida. As Heike assumes her new role as chair of the Publications Committee, I hope that each of you will feel free to share with her any ideas and suggestions that you might have about future articles for the Newsletter. And, of course, if you wish to author an article, contributions are most welcome.

The Section's committees continue to meet on a regular basis and address topics and issues of interest to our members. The Legislative Committee, chaired by Michael Stein, continues to follow-up on three draft statutes that it has produced over the past year. A task committee, led by Scott Small, has written a draft statute dealing with digital assets and has offered assistance to State Representative Tim Briggs, who is the primary sponsor of House Bill 2580 of 2012, which addresses this topic. Also in the works are the Committee's draft statute on UPMIFA and a "Directed Trustee" statute, which have been submitted for review and comment by the Joint State Government Committee and the Pennsylvania Bankers' Committee, respectively. The Legislative Committee is also exploring miscellaneous changes to various PEF Code provisions.

At its September meeting, the Tax Committee, led by Rebecca Rosenberger Smolen, hosted a presentation by Jonathan Sokoloff on the Medicare tax and the impact of the U.S. Supreme Court's DOMA decision on Pennsylvania residents. At its upcoming October meeting, the Tax Committee continues its longstanding tradition

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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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of hosting representatives from the Pennsylvania Department of Revenue to discuss a multitude of topics relating to Pennsylvania Inheritance Tax and Realty Transfer Tax. As usual, this promises to be an informative and lively meeting.

The Orphans' Court Litigation Committee, chaired by Tim Holman, continues to offer programs and discussions that are timely and important. At its September meeting, the committee discussed the McNeil case regarding income taxation of trusts in Pennsylvania. At its October meeting, the Elder Law Committee will host a brown bag lunch featuring representatives of the Elder Law Task Force formed by Pennsylvania Supreme Court Chief Justice, Ronald D. Castille, to learn about the Task Force's work and discuss issues relating to guardianships and elder abuse and neglect.

The Business Planning Committee, co-chaired by Dennis Reardon and Bob Louis, held a recent organizational meeting to brainstorm and come up with new ideas for committee activites. In November, the committee will host a discussion on succession planning in light of the 2013 tax legislation. The program will be open to members of the Probate Section, as well as to members of the Tax Section and the Business Law Section. Look for details concerning this program as they come across the Listserv.

At the Section's October Quarterly Lunch, the Education Committee, chaired by Laura Stegossi, and assisted by course planners, Benjamin C. Frick, Michelle J. Hong, and Evelyn G. Howard, presented a comprehensive program on issues relating to Health Care Powers of Attorney. The program's faculty, which included a practicing lawyer, a critical care physician and a hospital chaplain, provided a thorough and thought provoking discussion of the legal and practical issues that we must all consider in guiding our clients in this area. The program was well received, with attendance well in excess of 250, including those who attended offsite via web.

Our Young Lawyers Liaison, Alison Altman Gross, continues her tireless efforts to engage young members in our Section's work. In September, the Section hosted a happy hour and in November it will host a brown bag lunch featuring a presentation from Kelly Gastley from VIP, who will focus on pro bono opportunities. Members of our Diversity Committee, David Schwartz and Gordon Wase, attended the Chancellor's Forum on Diversity. The Executive Committee, through its Young Lawyers Liaison and through its Diversity Committee, remains committed to fostering new ways to encourage young and diverse lawyers to join and become involved in our Section.

The summary provided in this report is just that—a summary—and in no way captures all of the hard work that so many of our committee members, my fellow officers and Executive Committee members do on a continuing basis to help make our Section an important resource for all of us. To all of these Section members, I say thank you.

MARRIAGE BONUS OR PENALTY FOR SAME-SEX COUPLES

BY JP DOWDS | THE GLENMEDE TRUST COMPANY

In *United States v. Windsor*[1], the U.S. Supreme Court upheld a claim for refund of federal estate tax. The Internal Revenue Service had denied the marital deduction for value passing to Edith Windsor from the estate of her deceased spouse, Thea Spyer. The couple, residents of New York at the time of Ms. Spyer's death, had been legally married in Canada as authorized under the Canadian Civil Marriage Act. In order to reach its decision, the court declared Section 3 of the Defense of Marriage Act (DOMA) to be unconstitutional. The decision has broad implications, not only for estate planning but also, among myriad issues, for income tax planning and compliance. The income tax landscape for married same-sex couples ("MSSCs") is vastly changed; some will face a "marriage penalty" while others will benefit from a "marriage bonus" and MSSCs will find that the results vary greatly depending on the financial profile in each unique case. It seems that, at least with respect to the income tax challenges facing other married couples, MSSCs have finally achieved equality.

The purpose of this article is to examine the nature and extent of how the marriage bonus or penalty affects MSSCs in different economic circumstances. Ironically, *Windsor* forces them to trade one set of "no-choice" income tax filing rules for another. Under DOMA, a spouse in a same-sex marriage could file either as "single" or as "head of household" if requirements are met concerning care of a dependent child or certain other close relatives and the spouse bears more than half the cost of maintaining the home. That spouse could not file using either the "married filing jointly" or the "married filing separately" status. Now, the same spouse must use one of the married statuses and may not file as single or head of household.

The marriage penalty is the excess of the income tax liability of a couple filing a joint return over the sum of what the separate income tax liabilities of each spouse would have been if they were permitted to file separately as single taxpayers. This is not a provision of federal income tax law, but rather a reality resulting from the structure of tiered income tax "brackets". For 2013, all US taxpayers are subject to the same 10% income tax rate on the first $8,925 of taxable income. Progressively higher rates are imposed on higher layers of income until the "top tax bracket" is reached. Single taxpayers are subject to the 39.6% highest rate on taxable income in excess of $400,000. In contrast, a couple filing jointly begin to pay the top rate on the portion of their taxable income that exceeds $450,000.

The penalty is caused by the fact that a couple filing a joint return must combine their incomes, thus losing the advantage of the lower tax rates on what would be two separate sets of taxable income. The amount of combined income, the proportion of income earned by each spouse, the total of permissible itemized deductions, and the nature of the income all affect the extent of the marriage bonus or penalty. While a couple can take advantage of two separate "bracket run-ups" if they elect to file as "married filing separately", the structure of the rate schedule for that filing status is such that the sum of income tax bills paid by each spouse is typically higher than the tax to be paid by using the married filing joint filing status. For 2013, married couples who file separately begin to encounter the highest tax rate on taxable income that exceeds just $225,000.

Instead of a penalty, a marriage bonus will occur in some cases because of the expanded income tax brackets for joint filers compared to single filers. As we will see, this particularly works to a couple's advantage when one spouse earns all of the income since a greater portion of that spouse's income is taxed in the lower brackets.

In order to put the effects of the marriage penalty or bonus into perspective for MSSCs, facts have been invented for three theoretical

[1] *United States v. Windsor*, 570 US _____ (2013)

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couples with very different profiles designated as "the retirees", "the investors", and "the accumulators".[2] Also, there are variations for each couple based on the break-down of income earned by each spouse and the amount of their itemized deductions.

The alternative divisions of income for each theoretical couple are:

- 100% produced by one spouse; or
- 50% produced by one spouse and 50% by the other; or
- 75% produced by one spouse and 25% by the other.

The differing amounts of adjusted gross income (AGI) for each theoretical couple are:

- The retirees: $195,000
- The investors: $715,000
- The accumulators: $960,000

Another factor that has an important impact, as will be demonstrated, is the character and quality of the income subject to tax. Following are the percentages of AGI that consist of the total of qualified dividends and long-term capital gains for each couple:

- The retirees: 49%
- The investors: 100%
- The accumulators: 17%

In one set of variations, the total amount of itemized deductions is based on the average amount claimed by couples with similar amounts of incomes.[3] In the other set of variations, total itemized deductions for each couple are increased by 30%. In all cases, the deductions are treated as deducted in the same proportions as income produced. The resulting total itemized deduction amounts are:

- The retirees: $48,100 (first variation), increased by 30%: $63,700.
- The investors: $247,250 (first variation), increased by 30%: $342,450.
- The accumulators: $85,000 (first variation), increased by 30%: $122,200[4]

[2]"The retirees" - Pension: $100,000; Portfolio: $5,000,000 (60/40)*; Capital gains: $50,000
"The accumulators" - Wages: $800,000; Portfolio: $5,000,000 (80/20)*; Capital gains: $100,000
"The investors" – Portfolio: $35,000,000 (60/40)*; Capital gains: $400,000
*Equity/municipal bond split. Equity yield = 1.5%, bond yield = 2.5%

[3]Data on itemized deductions was obtained from the Internal Revenue Service's Statistics of Income 2010 Data, Table 3. http://www.irs.gov/uac/SOI-Tax-Stats---Individual-Statistical-Tables-by-Size-of-Adjusted-Gross-Income. The following adjustments were made to the data: Miscellaneous deductions were equal to .50% of the theoretical couple's portfolio size, representing investment fees paid; No casualty or theft loss deductions were assumed; and no medical expense deduction was assumed for "The accumulators".

[4]Amounts are listed net of phase-outs and threshold limitations (e.g. 2% floor for miscellaneous itemized deductions

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The following tables show the marriage bonus or (marriage penalty) for each alternative example:

Marriage Bonus or (Penalty) – Average Itemized Deductions			
	Retirees	Investors	Accumulators
Income proportions: 100% - 0%			
Marriage Bonus or (Penalty)	$11,017	$9,718	$11,170
As a % of AGI	5.6%	1.4%	1.2%
Income proportions: 75% - 25%			
Marriage Bonus or (Penalty)	$514	($16,598)	($21,396)
As a % of AGI	0.3%	(14.0%)	(7.8%)
Income proportions: 50% - 50%			
Marriage Bonus or (Penalty)	$0	($16,699)	($32,498)
As a % of AGI	0.0%	(14.1%)	(11.9%)

Marriage Bonus or (Penalty) – Average Itemized Deductions + 30%			
	Retirees	Investors	Accumulators
Income proportions: 100% - 0%			
Marriage Bonus or (Penalty)	$13,560	$7,985	$11,173
As a % of AGI	7.0%	1.1%	1.2%
Income proportions: 75% - 25%			
Marriage Bonus or (Penalty)	$1,287	($15,845)	($18,817)
As a % of AGI	0.7%	(14.1%)	(7.3%)
Income proportions: 50% - 50%			
Marriage Bonus or (Penalty)	$0	($14,592)	($23,415)
As a % of AGI	0.0%	(13.0%)	(9.1%)

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MARRIAGE BONUS OR PENALTY FOR SAME-SEX COUPLES, continued

Analysis of these results discloses certain patterns or trends:

- Where one spouse receives all of the income, a marriage bonus typically results. This is due to the aforementioned expanded tax brackets for joint filers, which allows the income-earning spouse to enjoy the benefits of taxation at lower tax brackets then would otherwise be available to him or her as a single filer.

- A more even division of income between spouses increases the marriage penalty. This occurs because the "married filing jointly" tax brackets, while expanded, are not exactly double those of the "single" tax brackets, thus leading to a quicker "run up the brackets" for joint filers. As a result, a greater percentage of a couple's income is taxed at higher rates.

- The marriage penalty increases as income increases. Two causes are apparent. First, the more taxable income, the more compressed the tax brackets become for joint filers relative to single filers. The second cause is the phase-out of itemized deductions, which was re-instated as part of the American Taxpayer Relief Act of 2012.[5] This phase-out, which works as a "stealth" tax increase, begins to apply once AGI exceeds $250,000 for single filers and $300,000 for joint filers.

- A higher percentage of investment income can increase the marriage penalty. The creation of the 3.8% net investment income tax on certain unearned income and the new 20% tax rate on qualified dividends and long-term capital gains have created a progressive rate structure for investment income that previously did not exist. Like the ordinary income tax brackets, the new "brackets" on investment income for joint filers is not exactly double those of single filers. This increased progressivity for joint filers creates the marriage penalty.

- When deductions are reported in proportion to income, increasing the itemized deductions reduces the marriage penalty, but, otherwise does not significantly change any of the preceding conclusions.

Prior to Windsor, MSSCs did not face the issue of equitable allocation of the income tax burden. Each spouse separately calculated and paid his or her tax bill. Now they have to decide how to divide the marriage bonus or penalty amount. Undoubtedly, many married couples, including MSSCs, pool their financial resources through the use of joint banking and investment accounts. In those cases, the division may have little significance. But for those who prefer to maintain separate accounts and contribute toward the payment of income tax, as well as all other expenses, the question of how to divide the cost presents itself.

While there may be numerous ways to allocate tax shares, two methods considered here for the sake of comparison are:

- Focus on that spouse who produces the lower amount of income (through earnings, investments or otherwise), calculate that spouse's income tax if he or she were permitted to use the "single" filing status, and allocate that amount of income tax to the lower-earning spouse with the higher-earning spouse paying the difference; or

- Allocate shares of income tax based on the proportions of adjusted gross income attributed to each separate spouse.

[5] American Taxpayer Relief Act of 2012, Pub.L. 112-240, H.R. 8, 126 Stat.2313

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The following tables show comparisons of the share of the income tax liability borne by the lower-earning spouse given these alternative approaches.

Allocation of Income Tax to Lower-Earning Spouse – Average Itemized Deductions			
	Retirees	Investors	Accumulators
Income proportions: 100% - 0%00			
Lower-Earner – Separate Tax Calc	$0	$0	$0
Proportionate Based on AGI	$0	$0	$0
Income proportions: 75% - 25%			
Lower-Earner – Separate Tax Calc	$915	$13,856	$50,328
Proportionate Based on AGI	$3,928	$29,574	$68,340
Income proportions: 50% - 50%			
Spouse 1[6] – Separate Tax Calc	$7,856	$50,798	$120,431
Proportionate Based on AGI	$7,856	$59,148	$136,680

Allocation of Income Tax to Lower-Earning Spouse – Average Itemized Deductions + 30%			
	Retirees	Investors	Accumulators
Income proportions: 100% - 0%			
Lower-Earner – Separate Tax Calc	$0	$0	$0
Proportionate Based on AGI	$0	$0	$0
Income proportions: 75% - 25%			
Lower-Earner – Separate Tax Calc	$518	$12,614	$49,135
Proportionate Based on AGI	$2,758	$28,030	$64,567

[6] Since there is no lower-earning spouse in this scenario, either spouse's income profile can be used for this calculation.

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MARRIAGE BONUS OR PENALTY FOR SAME-SEX COUPLES, continued

	Retirees	Investors	Accumulators
Income proportions: 50% - 50%			
Spouse 1 – Separate Tax Calc	$5,516	$48,763	$117,426
Proportionate Based on AGI	$5,516	$56,059	$129,134

Observations from this analysis are as follows:

- In every instance where one spouse is responsible for production of all of the taxable income, the non-earning spouse's allocated share of the tax is zero, as would be expected.

- Where there is a significant difference in the amount of income attributed to one spouse, as in the 75% - 25% example, and the shares of income tax are allocated proportionate to adjusted gross income, the income tax share of the lower-earning spouse is increased by a larger percentage.

- When the marriage penalty applies and the lower-earning spouse[7] calculates his or her share of the tax separately, the entire burden of the marriage penalty is left to the higher-earning spouse.

MSSCs are forced to examine their income tax withholding elections in view of this change. Those who can look forward to a marriage bonus may wish to reduce the withholding amount and the amount of any quarterly estimated tax payments, while those who face a marriage penalty should increase withholding or quarterly estimated tax payments in order to avoid a large balance due next April along with the prospect of an underpayment penalty. Depending on the method of allocation of contributions to total tax, the result may well be that one spouse decreases withholding or quarterly payments while the other spouse makes an increase.

In conclusion, the resulting effect of Windsor will be a changed income tax landscape for MSSCs. The nature of the change – marriage bonus or penalty – will likely be determined by not only who earns what percentage of the income, but also by the amount and character of the income. MSSCs will also encounter something new – a joint tax liability. Spouses who wish to pay "their fair share" of the resulting tax liability will need to come to an agreement on how best to calculate their percentage of their joint tax liability.

[7] Or "Spouse 1" in the scenario of two equal-earning spouses.

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MARRIAGE BONUS OR PENALTY FOR SAME-SEX COUPLES, continued

UPDATE:

On August 29, 2013, the Internal Revenue Service issued Rev. Rul. 2013-17. The ruling, which attempts to answer some of the outstanding issues created by the Windsor decision, is effective prospectively beginning on September 16, 2013. The ruling (and related FAQ's) generally extends the rights afforded married couples of the opposite sex under the Internal Revenue Code to those of the same sex. While the ruling addressed numerous issues, the following issues relevant to this article are listed below:

(1) The IRS will recognize the marriage of same-sex couples legally married in one state, but who now reside in a state where gay marriage is not recognized (such as Pennsylvania).

(2) The ruling does not extend to couples who have entered into registered domestic partnerships or civil unions.

(3) Taxpayers may, but are not required to, go back and amend any prior year tax return still open under the statute of limitations.

The full revenue ruling and accompanying FAQ's can be found at the following links:

http://www.irs.gov/uac/Newsroom/Treasury-and-IRS-Announce-That-All-Legal-Same-Sex-Marriages-Will-Be-Recognized-For-Federal-Tax-Purposes;-Ruling-Provides-Certainty,-Benefits-and-Protections-Under-Federal-Tax-Law-for-Same-Sex-Married-Couples

http://www.irs.gov/pub/irs-drop/rr-13-17.pdf

http://www.irs.gov/uac/Answers-to-Frequently-Asked-Questions-for-Same-Sex-Married-Couples

http://www.irs.gov/uac/Answers-to-Frequently-Asked-Questions-for-Registered-Domestic-Partners-and-Individuals-in-Civil-Unions

NEW WAY TO REMOVE TRUSTEE

BY CHARLES J. AVALLI | GENTILE HOROHO & AVALLI, P.C.

In 2010, the McKinney Family sought removal of the Corporate Trustee (PNC Bank) of two trusts that had been created by the family. On their behalf, the author of the article filed in Crawford County a Petition to Remove Trustee under Section 7766 of the Probate Estates and Fiduciaries Code claiming that there had been a substantial change of circumstances. After losing the case in the Lower Court, counsel took an appeal to the Superior Court and in an Opinion by Justice David N. Wecht, the Superior Court reversed the Lower Court, directing that the bank be removed as the Trustee and remanding for the Lower Court to determine the suitability of the proposed Successor Trustee. See *In re McKinney* 67 A3d 824 (Pa. Super, 2013). After remand, the Lower Court approved the proposed Successor Trustee and the McKinney family has a new Corporate Fiduciary in place.

STATUTORY BACKGROUND

When Pennsylvania adopted the Uniform Trust Code ("UTC") in 2006, many changes were made to trust law in Pennsylvania. Previously, the removal of a trustee was governed by 20 PA, C.S.A. §7121 which incorporated the grounds for removal of the personal representative found at 20 PA C.S.A. §3182. That section of the Probate Code, which had been law for decades, essentially required a determination of fault or misdeed on the part of the trustee in order for the trustee to be removed. When Pennsylvania adopted the Uniform Trust Code, it provided for fault bases to remove trustee – a serious breach of trust, lack of cooperation among co-trustees that substantially impairs the administration of the trust or the trustee being unable to effectively administer the trust because of unfitness, unwillingness or persistent failures. These fault based provisions, although not identical with prior law, certainly are substantially similar and did not remarkably change the requirements for the removal of a trustee. However, through §7766 b(4) the Legislature added a new ground not previously found in Pennsylvania law – that there has been a substantial change in circumstances.

In additional to needing to establish a substantial change in circumstance (or any of the fault provisions described above), in order to remove a trustee under the UTC as adopted by Pennsylvania at §7766, a party seeking removal must also establish that removal of the trustee:

• Best serves the interest of the beneficiaries of the trust

• It is not inconsistent with the material purpose of the trust

• A suitable successor trustee is available

In its *McKinney* decision, the Superior Court provided guidance not only as to what constitutes a "substantial change of circumstances" but also explained what "best serves the interest of the beneficiaries" and what is "not inconsistent with a material purpose of a trust". The Lower Court did not made a determination of the suitability of the proposed Successor Trustee because it found that the other requirements for removal under §7766 had not been met. Therefore, the Superior Court did not make any pronouncements with regard to the requirements for the suitability of a successor trustee. That issue alone was remanded to the Lower Court for determination so the *McKinney* appellate decision does not provide any guidance on that subject.

THE FACTS OF *McKINNEY*

As the case began, the *McKinney* family had eight substantial accounts with PNC. These accounts were either custodial or trust accounts. Six of the accounts were governed by documents which contained portability clauses that permitted the beneficiaries to terminate the relationship with PNC and appoint a successor. As the result of that circumstance, the McKinney family exercised their rights under the portability clauses and had the six accounts transferred to SunTrust Delaware for further administration pursuant to the terms of the applicable

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NEW WAY TO REMOVE TRUSTEE, continued

Agreements. Contemporaneously, the McKinney Family asked PNC to voluntarily resign as Trustee of the two remaining trusts. PNC refused.

The first trust that was left with PNC was a testamentary trust created under the Will of Donald L. McKinney, Jane McKinney's father. The initial Trustee of this trust was the Pennsylvania Bank and Trust Company. Through a series of mergers, Pennsylvania Bank and Trust became Penn Bank which then became Integra National Bank North, then Integra Bank, then National City Bank of Pennsylvania, then National City Bank, then PNC Bank.

The second trust at issue was the Jane McKinney Descendants' Trust which was created by Jane McKinney's mother on October 17, 1989. The Trustee designated in the Trust Agreement was Penn Bank and then pursuant to the mergers described above, ultimately became PNC Bank.

Although Jane McKinney's family had been among the founders of the Pennsylvania Bank and Trust Company and had lived for many generations in Northwestern Pennsylvania, Jane had moved from Pennsylvania in 1964, returning for visits but never again living there. At the time of the hearing, she was living in the Hampton Roads area of Virginia and all four of her children, who all joined in the Petitions for Removal, similarly lived there and none of them had ever lived in Northwest Pennsylvania.

Before the Lower Court, Jane McKinney argued for the removal of PNC and the appointment of SunTrust for the following reasons:

• The family no longer had ties to Northwestern Pennsylvania but rather resided in the Hampton Roads area of Virginia;

• Because of an inheritance Jane had received from her recently deceased mother, her financial planning and estate planning needs had substantially changed;

• There had been a turnover of staff within PNC such that the bank representatives handling the accounts with whom she had had long standing relationships all no longer worked with the Bank;

• It was beneficial for there to be one entity coordinating all of her investments and planning, rather than having the six accounts held at one institution and the remaining two accounts continuing to be held by PNC.

SUPERIOR COURT DECISION

In its decision, the Superior Court provides analysis of the meaning of best interests of the beneficiaries, the material purpose of the trust and substantial change of circumstances. These terms have not been previously interpreted by an appellate court in Pennsylvania and therefore the Superior Court's Decision provides great guidance to practitioners going forward.

The term "best interests of a beneficiary" is defined at §7703 of the Fiduciary Code. That section defines interests of the beneficiary to be "the beneficial interest provided in the trust instrument". The UTC commentary goes on to state that beneficial interest is not defined by the beneficiaries. The Superior Court explains that this means the best interests are defined pursuant to the provisions of the trust agreement not the subjective determinations of the beneficiaries. After examining the cases from other jurisdictions that addressed the issue, the Superior Court found that the following factors shall be considered in determining whether a current trustee or proposed successor trustee best serves the interest the beneficiaries:

• Personalization of service

• Costs of administration

• Convenience to the beneficiaries

• Efficiency of Service

• Personal Knowledge of trusts and beneficiaries' financial situation

• Location of Trustee as it affects trust income tax

• Experience

• Qualifications

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NEW WAY TO REMOVE TRUSTEE, continued

• Personal Relationship with beneficiaries

• Settlor's intent as expressed in trust document

After compiling this list of factors, the Superior Court also states that the Courts should also consider "any other material circumstances". This clearly indicates that the listing is not all inclusive and practitioners are free to present and the Courts are free to consider any other circumstances which would seem to reflect upon what serves the best interests of the beneficiaries.

Next the Superior Court interpreted the "material purpose of a trust". Important to the Superior Court's analysis is the fact that PNC Bank was not the chosen Trustee for either trust. When the creator of the trust has chosen the trustee whose removal is sought, some deference must be given to the Settlor's choice. However, in *McKinney*, because of the numerous mergers that had occurred, the institutions selected by the Settlors had long ago ceased to exist. The Trial Court believed that a material purpose of the Trust was that they be governed by a Pennsylvania institution. However, that analysis was rejected by the Superior Court and it held that the material purpose of the Trust is that the Trustee be able to effectively administer it. Therefore, where the former Trustee and proposed Successor Trustee both appear capable of effectively administering the trusts, the removal will not be found to violate a material purpose of the trust. It is important here to note that the statute does not require the new trustee enhance the material purpose of the trust. Rather, the statutory requirement is that the appointment of the new Trustee is not inconsistent with the material purpose of the trust.

The final issue analyzed by the Superior Court was whether a substantial change in circumstances had occurred such that PNC could be removed. First, the Superior Court notes that it could find no case law in this or any other jurisdiction that was helpful in its analysis. Also, the Superior Court noted that in 2010 §7766 was supplemented to include language that "a corporate reorganization of an institutional trustee, included a plan of merger or consolidation, is not itself a substantial change in circumstances". Obviously, the banking lobby was very instrumental in obtaining this amendment. However, the Superior Court found the string of mergers over the years which resulted in the loss of the bank personnel who had historically handled the account, coupled with the movement of the family to Virginia was sufficient to establish a substantial change in circumstances. The Superior Court noted that the change in personnel caused a change in the character of the services provided. It should be noted, as discussed above, that the change in circumstances does not need to be caused by some failure on the part of the corporate fiduciary. The Superior Court is clear that this portion of the removal statute is a "no fault" statute.

There are two other considerations addressed in the *McKinney* case which bear mentioning. First, the model statute of the Uniform Trust Code included as an additional basis for the removal of a fiduciary when all the beneficiaries agree to the removal. That provision, although law in other jurisdictions, is not the law in Pennsylvania. It was not included in the legislature's adoption of the UTC. Certainly if this was the law of Pennsylvania, Trustees would need to be more accommodating to the beneficiaries. Others can decide whether this assists or detracts proper trust administration.

Finally, the "price of poker" in trustee removal is always effected by the payment of legal fees. The law of Pennsylvania clearly provides that if a trustee successfully defends an effort for its removal that the trustee's legal fees are to be paid by the trust. In *McKinney*, the Lower Court's decision held that the costs of defense incurred by PNC were to be paid from the Trust and that determination was reversed by the Superior Court. Unfortunately for beneficiaries, in many cases the risk that those costs of defense will be assessed against the trust, by itself, provides ample reason for beneficiaries to not seek the

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NEW WAY TO REMOVE TRUSTEE, continued

removal of the trustee. Although some fiduciaries acquiesce to voluntary resignation when faced with beneficiaries who seek removal, other fiduciaries vigorously defend with costs of defense becoming a substantial impediment to seeking the relief. Perhaps the *McKinney* decision, although fact specific to its circumstances which are somewhat unusual, can provide beneficiaries an avenue to escape when the current trustee is no longer favored.

When Pennsylvania adopted the Uniform Trust Code, the law of trusts changed dramatically. Although it retained some that had previously been found in Pennsylvania common law or Chapter 71 of the Probate Estates and Fiduciaries Code, it added many new concepts - representation of parties of interest, modification of irrevocable trusts, and an entire section devoted to revocable trusts, among many others. There is very little appellate case law interpreting many of the "new" parts of the Uniform Trust Code. *McKinney* provides guidance to how a trustee, having fallen out of favor, may be replaced. Corporate fiduciaries have two schools of thought when faced with unhappy beneficiaries who seek to replace the trustee. The first school of thought is that the trustee will voluntarily resign, wanting to avoid the conflict that likely will ensue when the trustee/beneficiary relationship has soured. The other school of thought is that the trustee's job is not a popularity contest and the selection by the settlor imbues the trustee with the duty to serve as directed by the trust document. It is not the trustee's job to make all beneficiaries happy. In the competitive corporate fiduciary world, *McKinney* will surely be utilized not just by beneficiaries, but also by corporate fiduciaries seeking to develop new business, thus holding corporate fiduciaries to a higher service standard. Also, it makes an employment move by a trust officer, favored by the beneficiaries, an opportunity to seek a change of trustee to the new employer. The "balance of power" is changed in the corporate trustee world, and only time will tell how far the pendulum will go.

ETHICS COLUMN

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

What ethical issues do we face when a client requests our help in protecting their assets from creditors?

The asset protection question most frequently arises when a client is troubled by indebtedness, enmeshed in marital problems or worried about the looming expense of the care of an aged parent. Occasionally, too, architects, developers, doctors or others in occupations with a high potential for liability exposure ask us to develop plans to insulate their assets over the long term. Typically, they have learned about or even experienced, horrendous lawsuits.

Obviously, if we do not know or have insufficient information about the client, it is important that the client complete a detailed questionnaire about his or her assets, income and existing and potential creditors prior to discussing the issues. Normally, of course, we lawyers are obligated by Rule 1.3 to be committed to the client's interest and act with zeal and advocacy upon the client's behalf and to abide by a client's decisions concerning the objective of the representation. However, Rule 1.2(d) makes it clear we lawyers cannot "counsel a client to engage, or assist a client, in conduct that we know is criminal or fraudulent" and Rule 1.4(a)(5) mandates that we advise the client of the ethical limitations on our conduct when "the client expects assistance not permitted by the Rules of Professional Conduct or other law." Furthermore, Rule 4.4(a) prohibits our use or advocacy of means that "have no substantial purpose other than to embarrass,

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ETHICS COLUMN, continued

delay or burden a third person". That includes a client's creditors. Rule 8.4(c) provides that it is professional misconduct to "engage in conduct involving dishonesty, fraud, deceit or misrepresentation".

Lawyers have been subject to discipline pursuant to Rule 8.4 for recommending shell entities with no business purposes and asset transfers to prevent a creditor from executing on a judgment. *Attorney Grievance Commission v. Pak*, 400 Md. 567, 929 A.2d 546 (2007). See also ABA/BNA Lawyers Manual on Professional Conduct, 1001: 1801, (1995).

The safety net is Rule 1.2(d) that says lawyers may "discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law". Accordingly, the lawyer is permitted, and well advised, to engage in a thorough discussion of the laws pertaining to fraudulent transfers, the effectiveness of discovery in aid of execution or, in the case of the request to "help" the parents, the well-known "look back" rules and regulations in the Medicare arena. Such counseling usually will discourage the client from further consideration of hiding or improperly transferring assets. If the client persists, however, the lawyer may consider continuing the more routine aspects of estate planning and have the client sign an engagement letter, pursuant to Rule 1.2(c), that limits the scope of the lawyer's representation. The lawyer may then make use of the familiar techniques and spendthrift trusts, revise estate plans of family clients who would otherwise wish to benefit the client concerned about creditors, and suggest the retitling of some assets , all of which may be both helpful to the client and ethical. If that does not satisfy the client, then the lawyer is well-advised to consider terminating the representation pursuant to Rule 1.16.

If the client is in the high potential liability category, and anxious to insulate his or her assets over the long term, another ethical issue comes to the fore. Does the lawyer have the legal knowledge and skill reasonably necessary to provide competent representation pursuant to Rule 1.1? Sophisticated asset protection planning usually involves preparing technically challenging trusts with unique provisions and situses that most trust and estate lawyers do not regularly encounter. If the lawyer does not have the competence or the time to acquire the competence to undertake the assignment, then he or she should either decline the matter and refer the client to another lawyer or associate with special counsel who does have the requisite knowledge and skill.

Beyond the scope of this article, but worth remembering, is that we lawyers have more to be concerned about than violations of the Rules of Professional Conduct when representing a client attempting to dodge creditors. Pennsylvania is among those states that recognize civil liability for conspiracy to defraud and for aiding and abetting a fraud when the client's actions have harmed creditors.

WHAT WOULD YOU LIKE TO SEE IN FUTURE ETHICS COLUMNS?

Send your questions and ideas to:

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COURT LIMITS ABILITY OF PENNSYLVANIA TO TAX "OUT OF STATE" TRUSTS

BY CHRISTOPHER A. JONES | BALLARD SPAHR LLP

The Commonwealth Court of Pennsylvania, in *McNeil v. Commonwealth*,[1] recently held that the imposition of Pennsylvania personal income tax (PIT) on the worldwide income of two trusts that were administered in Delaware and governed by Delaware law was unconstitutional.

Pennsylvania law has long provided that a trust formed by a Pennsylvania resident is a Pennsylvania resident trust for PIT purposes, regardless of any other factors.[2] Department of Revenue (DOR) regulations further provide that the location of the trustees and beneficiaries are wholly irrelevant when determining whether a trust is a resident trust.[3]

In *McNeil*, the DOR assessed 2007 PIT on the worldwide income of two inter vivos trusts that were created by a Pennsylvania resident in 1959. Both trust agreements provided that the trusts were to be governed, administered, and construed under Delaware law. The sole administrative trustee, the Wilmington Trust Company, was located in Delaware, had no offices in Pennsylvania and conducted no trust affairs in Pennsylvania. Likewise, the trusts' three general trustees resided outside of Pennsylvania and did not conduct any trust affairs in Pennsylvania. No part of the trusts' assets or interests were located in Pennsylvania and the trusts had no Pennsylvania-source income in 2007. All of the trusts' beneficiaries were Pennsylvania residents during 2007. During 2007, one of the trusts made a discretionary distribution to one of its Pennsylvania-resident discretionary beneficiaries.

The trusts appealed the assessment of 2007 PIT arguing that, notwithstanding the PIT law, the trusts were nonresidents of Pennsylvania because they had no assets or trustees in Pennsylvania. Thus, the trusts argued that the imposition of PIT on the trusts' income from non-Pennsylvania sources violated the Due Process and Commerce Clauses of the United States Constitution.[4]

The Commonwealth Court relied on the Commerce Clause, as interpreted by the United States Supreme Court in *Complete Auto Transit, Inc. v. Brady*,[5] and ruled in favor of the trusts. In *Complete Auto Transit*, the Court established a four-part test to determine whether a state tax withstands Commerce Clause scrutiny.[6] In order for a state to impose a tax: (1) the taxpayer must have substantial nexus with the taxing state; (2) the tax must be fairly apportioned; (3) the tax must be fairly related to the benefits conferred upon the taxpayer by the state; and (4) the tax may not discriminate against interstate commerce. If a tax fails any of the four tests, the state is precluded from imposing the tax.

With respect to the first prong of the *Complete Auto* test, the Commonwealth Court made clear

[1]67 A.3d 185 (2013).

[2]72 P.S. § 7302(a).

[3]61 Pa. Code § 101.1.

[4]The trusts also relied on DOR Ruling No. PIT-01-040 and argued that the imposition of PIT was improper in light of DOR policy. The court rejected this argument before turning to the Constitutional claims.

[5]430 U.S. 274 (1977)

[6]nterestingly, the Commonwealth Court assumed without discussion that the Commerce Clause restricts state taxation of trusts that, arguably, were not themselves engaged in interstate commerce.

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that it is the trusts, not the settlor or beneficiaries, that must have substantial nexus with Pennsylvania. Under the United States Supreme Court decision in *Quill Corp. v. North Dakota*,[7] the substantial nexus prong is satisfied only if a taxpayer has a physical presence in the taxing state. Thus, the court looked to whether the trusts had any physical presence in Pennsylvania that would allow for the imposition of PIT on the trusts.

The Commonwealth Court agreed with the trusts that their only two contacts with Pennsylvania were (i) the residency of the settlor in 1959 and (ii) the residency of the beneficiaries in 2007, neither of which were sufficient to establish substantial nexus with Pennsylvania under *Complete Auto Transit and Quill*. The court rejected the DOR's argument that the location of the beneficiaries established substantial nexus in part because the DOR's own regulations provide that the residency of the beneficiaries is irrelevant. Likewise, the court held that the settlor's residency in 1959 did not provide physical presence in Pennsylvania because the settlor chose to have the trusts governed by Delaware law, established the administration of the trusts in Delaware, and did not reserve any continuing control over the trusts after formation. Thus, any contact with Pennsylvania amounted only to the "slightest presence" and not substantial nexus as required by the United States Supreme Court.

Although the Commonwealth Court held that the imposition of PIT on the trusts failed the first part of the *Complete Auto Transit* test, it also addressed the second and third parts of the test. With respect to the second test, the court stated that, because the trusts had no physical connection with Pennsylvania, the imposition of tax on all of the trusts' income was plainly out of proportion to any contacts that the trusts had with Pennsylvania. Consequently, the court also held that the imposition of PIT on all of the trusts' income failed the second part of Complete Auto Transit, the fair apportionment test.

Finally, the Commonwealth Court also held that the imposition of PIT on the trusts' income failed the third part of the *Complete Auto Transit* test because the PIT was not fairly related to services provided by the state to the taxpayer. The court restated that the trusts, not the settlor or the beneficiaries, were the relevant taxpayers for these purposes. Because the trusts had no physical connection with Pennsylvania during 2007, the trusts did not benefit from any services provided by Pennsylvania. As a result, the court held that it was impossible for the imposition of PIT on the trusts to satisfy the fairly related part of the *Complete Auto Transit* test.

Because the court held that the imposition of PIT on the trusts failed three parts of the *Complete Auto Transit* test, it abated the assessment of PIT in its entirely along with all interest and penalties. The DOR did not appeal the decision of the Commonwealth Court.

Although *McNeil* is now the law in Pennsylvania, the reach of its holding is unclear. Certainly, after *McNeil*, the DOR cannot impose PIT on a trust if the trust's only connection to Pennsylvania is the residence of the settlor. Because, under the PIT law and regulations, the residency of the settlor is the sole factor in determining the residency of a trust, the *McNeil* discussion calls into question the entire foundation of imposing PIT on trusts.

For example, after *McNeil*, can Pennsylvania impose PIT on a trust created by a Pennsylvania resident if (unlike the trusts in *McNeil*) the trust has other connections to Pennsylvania? If so, what connections are enough to constitute substantial nexus with Pennsylvania under *Complete Auto Transit*? Assuming that some trusts still are resident trusts under Pennsylvania law, does the Commonwealth Court's discussion

[7] 504 U.S. 298 (1992).

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PRACTICE POINTS

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

In Pennsylvania the administration of a decedent's estate is not routinely court-supervised, thus annual accountings and/or reports are not routinely due to the court for audit and approval. Court supervision is likely to occur when a troubled estate administration is brought to the court's attention by an aggrieved party. During the administration of a decedent's estate, there are some controls that the Register of Wills can exercise in connection with the administration. One meaningful control mechanism is that no short certificates will be issued by the Register after the initial allotment obtained is used or becomes stale, unless the Inventory is timely filed with Register's Office and any outstanding, additional probate fees are paid.

This situation arises frequently, because often personal representatives and their attorneys, at the time of application for probate, "lowball" the size of the decedent's estate. This may be unavoidable because where information is unavailable or sketchy. Often this because there is a general misconception regarding refunds of excess probate fees paid. Generally it is a result of both of the aforesaid. Although in some counties there may be a policy that no excess probate fees are ever to be refunded under any circumstances, this is not the case in Philadelphia County.

Refunds of probate fees paid may be due for various reasons, and the refund procedure may vary accordingly at our Register's Office, depending on how the refund was generated. This "Practice Point" is not intended to exhaustively describe all of those possibilities. One example is when the result of probating an estate in which all of the assets turn out to be non-probate, and the estate should not never have been probated (There may be instances where an executor has to be appointed for a decedent even though there are no probate assets, in order to obtain the information). However, if a short certificate is used to obtain the needed information, the Register will generally not refund any probate fee. Generally a refund will be refunded when it is generated by the decreased value of the estate reported. For example, the refund may be due to inadvertently overstating the value of the estate at probate, which is then revised and corrected by the time the Inheritance Tax Return is filed. In this kind of situation, the personal representative or the attorney should write to the Legal Department of the Office of the Register of Wills with an explanation, include a copy of the final appraisement from the Inheritance Tax Bureau, and a copy of the original receipt for the probate fees already paid. A refund will be issued (possibly less a small processing fee) within two weeks. A policy promulgated by the Register's Office is that refunds of such excess probate fees paid which is generated more than four (4) years after the death of the decedent, will not be paid, due to the increased expense associated with researching older files, all of which must be done manually. This is intended by the Register's Office to encourage the prompt, timely and complete administration of a decedent's estate.

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.

"OUT OF STATE" TRUSTS, continued

of the fair apportionment and fairly related tests mean that a resident trust is subject to PIT only on an apportionable share of their income, rather than all worldwide income? If so, what factors are relevant in apportioning a trust's income?

Because it may be a substantial period of time before any of these questions are addressed by Pennsylvania courts, the next guidance may come from the DOR or from the General Assembly in the form of legislation. For now, however, Pennsylvania's ability to impose the PIT on trusts characterized as resident trusts under the PIT law is very much called into question.

CASE SUMMARY FROM THE ORPHANS' COURT LITIGATION COMMITTEE

Bitschenauer, Incapacitated, 3 Fiduc. Rep. 3d 186 (O.C. Div. Phila. 2013)

BY TIMOTHY J. HOLMAN | SMITH KANE, LLC

When serving in a fiduciary capacity, one must keep meticulous records explaining how one acted in that role. This concept is especially important when one acts as Agent under Power of Attorney. Legion are the fiduciaries who have met with woe because they could not produce receipts or provide proper and logical explanations for checks written, charges appearing on credit card statements, et cetera. Fiduciaries must account for each and every dollar that passes through their hands. Indeed, one who reviews the case law or practices regularly in this area will get the sense that many fiduciaries – especially Agents under Powers of Attorney – simply never understood their record-keeping and accounting obligations when they agreed to act in that capacity. The recent opinion of Judge Herron of the Orphans' Court of Philadelphia County, *Bitschenauer, Incapacitated,* 3 Fiduc. Rep. 3d 186 (O.C. Div. Phila. 2013), serves as a helpful guide on this critical issue.

In addition to the importance of good record-keeping, *Bitschenauer* also discusses the important issue of whether an Agent under a Power of Attorney is authorized to make gifts on behalf of the principal. Many Agents under a Power of Attorney think something along the lines of the following: "Mom always wrote checks to the grandkids for their birthdays, and at times wrote larger checks to her children (even me), so I must be able to do the same." Some Agents under a Power of Attorney take gifting to a more extreme level and make substantial gifts to themselves, friends or family members, under the logic that "Mom named me as Agent under her Power of Attorney, and that means that I get to make all of the decisions (including the decision to make large gifts to the Agent and/or his or her family)."

In fact, the Agent under Power of Attorney has a fiduciary relationship with the principal that includes the duty to, " 1) Exercise the powers for the benefit of the principal; 2) Keep separate the assets of the principal from those of an agent; 3) Exercise reasonable caution and prudence; 4) Keep a full and accurate record of all actions, receipts and disbursements on behalf of the principal. See 20 Pa. C.S.A. §5601(e). In the absence of language in the Power of Attorney itself expressly waiving these bedrock principles, all agents under a power of attorney must abide by them. Indeed, Agents in Pennsylvania are required to sign a document when they accept the appointment as Agent in which they expressly agree to uphold those principles. Nevertheless, and unfortunately for them and the principals they serve, Agents often fail to heed these duties – especially the obligation to keep full and accurate records.

Bitschenauer shows the consequences of keeping unorganized records (and of dishonesty) while acting as an Agent. In the case, Anna Bitschenauer ("Bitschenauer") named Barbara Louise Tucker ("Tucker" or "Agent") to serve as her Agent. Bitschenauer had lost all of her family members and trusted Tucker, who had done investing for her in the past. Bitschenauer did not give the Agent any gifting authority, and crucially, included a clause in the Power of Attorney stating, "[m]y agent shall not be entitled to compensation for serving as agent hereunder, but shall be entitled to reimbursement for reasonable out of pocket expenses." Despite the express prohibition against compensation for the Agent, the Agent in fact paid herself $87,505.00 as compensation for her duties as Agent. Not content to compensate herself only, the Agent also paid her husband $270,138.00 using her agency powers, allegedly as "a loan or advance" for work that he apparently intended to perform in the future for Mrs. Bitschenauer.

The problem with the Agent's decision to pay herself and her husband should be obvious. She directly contradicted the power of attorney document that did not

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allow her to pay herself. Beyond this blatant misconduct, the Agent's poor recordkeeping caused her severe financial consequences. The Court relied on *Pettit Estate*, 22 Fiduc. Rep. 2d 182, 193 (O.C. York Cty. 2001) in establishing that "when an individual renders personal services to another, 'evidence of the value of such services rendered and accepted is sufficient if it affords a basis for estimating with reasonable certainty what the claimant is entitled to." The Agent in *Bitschenauer* failed to keep adequate records of her Agency, and was unable to provide evidence of any of her financial dealings.

For example, the Agent alleged that she distributed $27,875 in cash withdrawals to Mrs. Bitschenauer to use for "her day to day expenses and outings." However, the Agent admitted that she lacked any documentation of the purpose of those cash withdrawals. The Agent kept no receipts, and could not even prove that the principal received those funds. As a result of the Agent's complete lack of recordkeeping, Judge Herron ordered the Agent to return $27,875 to the Estate.

The Agent also improperly paid her husband, Michael Tucker, $270,138. She claimed that the payment was for cleaning Mrs. Bitschenauer's apartment, doing her laundry, and giving her medicine, even though Mrs. Bitschenauer's nursing home already performed those tasks for the principal. The Agent kept no time records, and had no proof of the services provided to Mrs. Bitschenauer. Even more problematically, the Agent characterized the payment to her husband as a "loan" in her testimony. The Agent testified that her husband was paying back the loan, which did not bear any interest, by cleaning for and giving medicine to Mrs. Bitschenauer. According to the Agent, the outstanding amount of the loan to her husband was $160,000, taking into account the work he already performed. However, she did "not know the exact number," and had no loan documents. The Agent provided no proof of the work performed by her husband, and it did not appear in the accounting as a loan. The Agent even admitted that it wasn't wise of her to give her husband the money as a loan. Due to the Agent's lack of credibility and complete lack of records, she was ordered to return the $270,138 in payments to her husband to the Estate.

With regard to the $87,505 in payments to herself, the Agent again had no documentation of the services she performed. Aside from completely contradicting the terms of the power of attorney document, which did not allow the Agent to pay herself for her services, the Agent failed to give credible testimony. For example, in 2005 the Agent paid herself $33,700 for her services at a rate of $35.00/hour. This meant that the Agent claimed to have worked 20 hours per week for Mrs. Bitschenauer while she was working 50 hours per week as a financial advisor and raising two children. The Agent couldn't support this incredible statement with any records, and was ordered to return $87,505 to the Estate.

Finally, the Agent made gifts of $12,000 to herself and to her husband in 2005 and 2006. Altogether, she gave herself and her husband $48,000 in gifts. The Agent failed to identify any of those distributions as gifts in her Account. Instead, she characterized each of those $12,000 distributions as reimbursements for "out of pocket expenses, mileage, and services rendered." The Court viewed the discrepancy between the Agent's testimony and the Account as a concession of the "unreliability of her accounting." Further, the power of attorney document did not provide the Agent with any gifting authority. It is well-established law that a power of attorney document must provide for gifting authority to authorize the Agent to make gifts. As such, the Court ordered the Agent to return $48,000 to the Estate.

I cannot emphasize enough the importance of realizing, and explaining to your clients, that when you act as Agent under Power of Attorney, you should assume that

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BITSCHENAUER, continued

you will be asked to account for your actions as Agent.

Further, you must emphasize to your clients the importance of reading and understanding the power of attorney document. Had the Agent in *Bitschenauer* read or respected the power of attorney document, she would have known she could not make gifts and that she could not pay herself for acting as Agent. As happened in *Bitschenauer*, keeping poor records may leave a Court with no option but to conclude that an Agent has mismanaged the principal's money.

By reading and understanding the power of attorney document and keeping detailed records, an Agent under Power of Attorney can avoid future misunderstandings, costly litigation, and the treacherous task of attempting to recreate records of her Agency.

JOIN A COMMITTEE

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

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TAX UPDATE

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

FEDERAL ESTATE TAX

Same-Sex Marriage

United States v. Windsor, 570 U.S. ___ (2013) (Docket No., 12-307)

The Supreme Court ruled that 1 U.S.C. §7, also known as Section 3 of the Defense of Marriage Act ("DOMA") (1996), is unconstitutional because it violates the due process protections of the Fifth Amendment of the U.S. Constitution, the concept of equal protection as applied to the federal government and principles of Federalism. Section 3 provided the following:

In determining the meaning of any Act of Congress, or of any ruling, regulation, or interpretation of the various administrative bureaus and agencies of the United States, the word "marriage" means only a legal union between one man and one woman as husband and wife, and the word "spouse" refers only to a person of the opposite sex who is a husband or a wife.

The Court held that Section 3 "undermines both the public and private significance of state-sanctioned same-sex marriages" and found that "no legitimate purpose" overcomes section 3's "purpose and effect to disparage and to injure those whom the State, by its marriage laws, sought to protect[.]" Windsor, 133 S. Ct. at 2694-95.

DOMA barred same-sex spouses from any marital benefits provided by the federal government, including certain gift and estate tax exemptions, social security, and spousal benefits for federal employees. As a result of the ruling, in states where marriages between same-sex couples are legal, the federal government can no longer deny federal benefits to any married couple.

Windsor originated in a request for refund of estate taxes. The plaintiff, Edie Windsor, and her partner, Thea Spyer, were partners in a committed same-sex relationship for three decades. In 1993, they registered as domestic partners in New York City and in 2007, they were married in Canada. When she died in 2009, Spyer left her entire estate to Windsor, who was assessed $363,053 in federal estate tax because the IRS found that the estate did not qualify for the marital deduction.

Revenue Ruling 2013-17, 8/29/2013

In order to implement the federal tax aspects of the Supreme Court's ruling in *United States v. Windsor*, 570 U.S. __ (2013) [see above], the IRS issued a Revenue Ruling providing that a same-sex couple who was legally married in jurisdictions recognizing the marriage will be treated as married for federal tax purposes, whether or not the couple lives in a jurisdiction that recognizes same-sex marriages. The Revenue Ruling applies to taxpayers in any same-sex marriage legally entered into in one of the 50 states, the District of Columbia, a U.S. territory, or a foreign country. Such marriages are recognized for federal tax purposes, whether or not couple's current state of residence does not recognize same-sex marriages. The IRS states that this policy amplifies and clarifies its long-standing position, set forth in Rev. Rul. 58-66 in the context of the recognition of common-law marriages, that for federal tax purposes, the IRS recognizes marriages based on the law of the state in which they were entered into and disregards subsequent changes in domicile. This Revenue Ruling explicitly does not apply to registered domestic partnerships, civil unions, or other similar formal relationships recognized under state law.

Under the Revenue Ruling, same-sex couples are to be treated as married for all federal tax purposes, including income, gift and estate taxes.

The terms of this Revenue Ruling take effect on September 16, 2013, but taxpayers may choose to rely on its terms for earlier periods whose statutes of limitations have not expired.

The IRS presents four principal reasons for concluding that the terms "husband and wife," "husband" and "wife" are to be

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interpreted to include same-sex spouses: first, the Windsor ruling demonstrates that the Supreme Court was well aware that its decision to strike down section 3 of DOMA would have broad implications for tax administration. Secondly, in accordance with the canon of construction of constitutional avoidance, which states that, "where an otherwise acceptable construction of a statute would raise serious constitutional problems," a court should "construe the statute to avoid such problems unless such construction is plainly contrary to the intent of Congress," *United States v. X-Citement Video, Inc.*, 513 U.S. 64, 78 (1994), the IRS cannot construe the gender-specific terms in the Code in such a way as to categorically exclude same-sex spouses. Thirdly, the way in which Section 7701 of the Internal Revenue Code defines the terms "husband and wife," "husband" and "wife" makes possible a gender-neutral interpretation of these terms elsewhere in the Code, and this interpretation is also consistent with the legislative history. Fourth, a gender-neutral reading of these terms fosters fairness and administrative efficiency.

The rule that the recognition of same-sex marriages is not dependent on the current domicile of the couple avoids costly administrative burdens on employers in administering employee benefit plans.

Transferee Liability

U.S. v. Mangiardi, 112 AFTR 2d ¶ 2013-5108 (DC Florida, 7/19/2013)

The U.S. District Court denied a motion to dismiss a transferee liability case brought by the IRS and sustained the IRS' proposed collection actions, applying the ten-year statute of limitations under IRC §6324, the lien for unpaid estate tax.

The Estate of Joe Mangiardi, who died in early 2000, requested and received six extensions of time to pay the $2.6 million in estate tax owed, basing its requests on the grounds that the assets to be used to pay the tax were marketable securities that were undervalued due to poor market conditions. In 2006, the IRS served a levy notice on the Estate for unpaid estate taxes.

The decedent's daughter, who was executrix of his estate and co-trustee of his revocable trust, had, along with the other co-trustees, unsuccessfully engaged in active trading of the $4.5 million in marketable securities held by the estate and the trust during the period of the estate tax extensions. They also paid themselves hundreds of thousands of dollars in fees. At the time the levy notice was received, the Estate declared itself insolvent and unable to pay the $3 million in estate taxes it owed.

The executrix argued that, because the estate was subject to the four-year statute of limitations under IRC § 690,1 the IRS could no longer recover the $400,000 share of the assets which she had received from the decedent's IRA.

The district court ruled in favor of the IRS and stated that the relevant statute of limitations was actually the ten years statute of limitations under IRC §6324, reasoning that, because the liability of the transferee was derivative of that of the transferor (i.e., the estate), the statute of limitations was also derivative. The decedent's death automatically created a ten-year lien on the decedent's gross estate in favor of the U.S. Therefore, when estate property was transferred to the daughter, the lien remained with the property and the daughter took the assets subject to the lien. The daughter was liable for property transferred to her that was includable in her father's gross estate to the extent of the value of such property at the time of his death.

IRC § 6166 Estate Tax Installment Payment Arrangement

Estate of Franklin Z. Adell, T.C. Memo. 2013-228 (September 30, 2013)

The Tax Court ruled that late payment of interest allowed the IRS to terminate an estate's election under IRC § 6166 to defer the payment of estate taxes and was not an abuse of discretion. It held that it was not material to the case

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that the final valuation of the estate was still pending.

The Estate of Franklin Z. Adell made several years of installment payments under an IRC § 6166 deferral of estate tax arrangement. It then successfully applied for and received additional extensions because of its inability to pay and because of estate litigation issues. When the IRS increased its valuation of the date of death value of a stock by $92 million and decided to demand payment of penalties and interest on the nondeferred estate tax, the estate filed a protest. The Tax Court ruled in favor of the IRS and allowed it to terminate the deferred payment arrangement under §6166(g)(3)(A) because of the estate's late payment of interest.

FEDERAL GIFT TAX

Steinberg v. Comm., 141 T.C. No. 8 (September 13, 2013)

The Tax Court denied the IRS' motion for summary judgment and ruled that a net gift agreement, in which the donees assumed responsibility for applicable gift taxes and for any increase in federal estate taxes imposed on the donor's estate under IRC §2035 (b) relating to the gift, effectively reduced the value of the gift for gift tax purposes. In making this ruling, the Court refused to follow its prior ruling in *McCord v. Commissioner*, 120 T.C. 358 (2003), which held that a net gift obligation did not reduce the value of the gift for gift tax purposes.

When the 89 year-old donor made gifts to her daughters, they agreed to pay the federal gift tax liability and any federal or state estate tax imposed a result of the inclusion of the gifts in the donor's estate if she died within three years of making the gifts. Her appraiser valued the net gift for gift tax purposes by reducing its fair market value by the gift tax paid by the donees and the actuarial value of their assumption of the potential estate tax. Citing *McCord*, The IRS argued that the reduction in value should be disallowed because the donee's assumption of the potential estate tax liability had no value.

The Court held that *McCord* had been incorrectly decided, and that it was not "too speculative" to determine the amount of an estate tax that may be in effect when a taxpayer died, even if the potential estate tax might never be paid. The Tax Court also rejected the "estate depletion" argument, i.e. that the donee's assumption of the IRC §2035 (b) tax accrued to the benefit of the donor's estate rather than to the donor. Rather, it found that the donee's assumption of the estate tax liability amounted to consideration in money or money's worth under IRC §2512 (b).

PENNSYLVANIA

Inheritance Tax Exemption for Transfers of Qualified Family-Owned Businesses

Act 52 (HB 465), a statute exempting transfers of qualified family-owned businesses to one or more family members from Pennsylvania Inheritance Tax, was signed into law on July 9, 2013. Act 52 defines a qualified family-owned business interest as an interest in a business with less than 50 full-time equivalent employees, with a net book value of assets of less than $5 million, and which has been in business for at least five years as of the decedent's date of death. The interest in the family-owned business must continue to be owned by a qualified transferee, who may be the decedent's surviving spouse, a lineal descendant, a sibling or the sibling's lineal descendants, or ancestors and their siblings, for at least seven years after the decedent's date of death. The principal purpose of the entity must not be "the management of investments or income-producing assets owned by the entity." The entity must file an annual certification form with the Department of Revenue demonstrating that the entity continues to qualify for the exemption. The owners of the business must notify the Department of Revenue within thirty days of any event causing the business interest to fail to qualify for the exemption. If the exemption is lost, either because the entity no longer qualifies for the exemption or the entity has not complied with the certification or notification requirements, inheritance tax plus interest is due.

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PROBATE AND TRUST LAW SECTION COMMITTEE INFORMATION

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

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

Education Committee. The Education Committee meets during the year to discuss current topics relevant to the Section. Those topics become the basis for three programs (March, June and October) that provide CLE credits for program attendees. The Committee is responsible for choosing topics, outlining the content of the programs, and then selecting and recruiting qualified panelists to provide a two-hour presentation at the quarterly meetings. After the presentations are completed, the Committee reviews the evaluations that are generated from program attendees and utilizes those evaluations to improve upon future programs. The Committee welcomes suggestions for future program topics, and any interested Section members are encouraged to join the Committee by contacting Committee Chair Laura Stegossi at 215.972.7918 or lstegossi@wglaw.com.

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

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

Orphans' Court Committee. The Orphans' Court Litigation Committee meets monthly on the second Tuesday of each month except for June, July, August, and December. The meetings begin at 8:30 am in the morning at One Liberty Place in Center City. An agenda for each meeting usually involves a presentation and a discussion of a recent Orphans' Court

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case as well as issues and fact patterns that Orphans' Court litigators will frequently encounter. Following the presentation, a lively discussion among the committee members addresses the designated topic, and how the committee members have dealt with the issues and fact patterns in practice. For more information about this committee, please contact Committee Chair, Timothy J. Holman, at (610)-518-4909, or at tholman@smithkanelaw.com.

Publications Committee. The purpose of the Publications Committee is to further the knowledge and practices of members of the legal community through the publication of articles in this Probate and Trust Law Section Newsletter that are current, relevant and informative. The Newsletter generally is published three times per year. The Publications Committee holds meetings on an ad hoc basis. For information, please contact committee chair Heike K. Sullivan at sullivanh@ballardspahr.com.

Rules and Practice Committee. The Rules and Practice Committee drafts local rules and the forms to accompany them, which are suggested to the Committee by the Judges of the Orphans Court Division of the Court of Common Pleas, local practitioners, or which the Committee determines are needed in connection with practice before the Orphans Court Division or the Office of the Register of Wills. Over the past years this Committee has published the Green Book, Blue Book and Red Book and updated them as needed. It has reviewed and commented upon the new proposed statewide Orphans Court Rules, reviewed the first draft of the Guardianship Manual, and drafted rules and forms for local use which also served as guides for the statewide forms now in effect. This committee also addresses procedural problems which come to its attention for the benefit of the Court and practitioners, and generally resolves such problems. For more information, please contact committee chair Bernice Koplin at bjkoplin@sglk.com.

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

Young Lawyers Committee: The Young Lawyers Committee meets periodically to provide opportunities for younger members of the Probate Section to get to know each other and learn about the Section's activities. Activities include brown bag lunches and happy hours. If you are interested in getting involved with the Young Lawyers Committee, please contact Alison Altman Gross at alison@altmangross.com.

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

November Luncheon Program
November 19, 2013
11:45 a.m. - 1:45 p.m.
The Union League
140 S. Broad Street, Philadelphia, PA
Topic: "Trends in Philanthropy"
Speaker: Doug Bauer

Holiday Celebration
December 2, 2013
5:30 – 7:30 p.m.
Crystal Tea Room
100 E. Penn Square, Philadelphia, PA

January Luncheon Program
January 21, 2014
11:45 a.m. - 1:45 p.m.
The Union League
140 S. Broad Street, Philadelphia, PA
Topic: "Digital Death and Estate Planning for Social Media"
Speaker: Robert Kirkland

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