PHILADELPHIA BAR ASSOCIATION

Probate and Trust Law Section Newsletter

Published by the Section on Probate and Trust Law of the Philadelphia Bar Association

SEPTEMBER 2014 | NO. 137

REPORT OF THE CHAIR

BY KAREN M. STOCKMAL, ESQUIRE | KMS LAW

I remember the advice I was given as a second year associate as I attended my first Education Committee meeting. "Just keep showing up and pretty soon you'll be running things," someone told me. Funny, I thought, but not likely. Fourteen years later, I am finishing my final year as an officer and while I have never felt like I was "running things" due to the incredible team-work we employ, I've given others the same advice that I received many times. Stick around, it's an amazing place to be.

As I wind down the four year officer rotation, it occurs to me what a tremendous privilege it is to be a part of this Section. Several years after joining the Education Committee I became a committee co-Chair, then the committee Chair, then a member of the Executive Committee and then an officer. In that time I had my children, left a large firm and started my own. Each new opportunity in the Section afforded a deeper level of understanding about how this amazing organization functions and a chance to meet new people, many of whom have become mentors, referral sources, colleagues and friends. The annual meeting has become a sort of family reunion for me, with an opportunity to see friends that I would not otherwise see, but with whom I remain close and a phone call away, if needed. These people are a part of my life, not just my work.

Many attorneys have told me that they don't have time to spend working in the Section, because they have to spend their nonbillable work time on marketing. I can only comment on my own experience, but my practice would not exist without the support and referrals from those I met in the Section. Indeed, for every three referrals that brought me new clients in 2014, two came from Section members. So, I'm letting you in on a secret. Time spent working in the Section provides the best return on investment (ROI for you marketing types) I could possibly hope for.

continued on page 3

IN THIS ISSUE

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:

Heike K. Sullivan
email: sullivanh@ballardspahr.com

THE UNIFORM FIDUCIARY ACCESS TO DIGITAL ASSETS ACT: THE INFORMATION SUPERHIGHWAY NOW HAS HOV LANES FOR FIDUCIARIES

BY SCOTT S. SMALL, SENIOR VICE PRESIDENT AND SENIOR REGIONAL FIDUCIARY MANAGER | WELLS FARGO PRIVATE BANK[1]

INTRODUCTION

Did you hear the one about the person who sold virtual real estate in a multiplayer universe online game for over $600,000 of very real dollars?[2] Or the one about the decedent who owned a domain name that was sold for over $13 million dollars?[3] A steadily increasing number of clients are involved in online banking, investing, bill paying and tax filing, as well as engaging in gaming and business social networking sites. At the end of July, 2013, an online service known as Qmee reported that the following transactions occur on the Internet every 60 seconds: 70 new domain names are registered, 17,000 transactions occur on Walmart.com, $83,000 of sales transpire on Amazon.com, 20,000 photographs are uploaded to Tumblr, 104,000 photos are shared on SnapChat, 278,000 tweets are sent on Twitter, 2 million searches occur on Google, 20 million photos are viewed on Flickr, and 204 million e-mails are sent.[4] Every sixty seconds!

Overlooking a client's digital assets can lead to financial loss for beneficiaries and fiduciary risk for executors and trustees, but gaining information and access to those assets is a challenge. This presentation is intended to discuss current legislation attempting to deal with digital assets and provide helpful hints on how to incorporate the access rights and distribution of digital assets into estate planning.

BACKGROUND

Most digital property has little or no financial value,[5] but those items of digital property with financial value must be included in state and federal inheritance and estate tax returns, and in the inventory and accountings of guardianships, conservatorships, decedents' estates or trust administration. Separate and apart from intellectual property rights such as trademark and copyrights, forms of digital property such as domain names, advertising revenue from Web pages or blogs or social media have financial value.

1 The opinions and views expressed in this material are those of Mr. Small and do not constitute any representation of the opinions or views of his employer, Wells Fargo Bank, N.A..

2 Planet Calypso Player Sells Virtual Resort for $635,000 USD, PR NEWSWIRE (Nov. 12, 2010)

(Entropia Universe was the game).

3. Sex.com was sold in 2010 by Escom LLC (then in bankruptcy) to Clover Holdings LLC. Escom LLC was the alter ego of Gary Kremen, who died in 2006.

4. Online in 60 Seconds, Blog.qmee.com/qmee-online-in-60-seconds/ (July 24, 2013).

5. *But see* Greene, Passing Down Digital Assets, WALL STREET JOURNAL (Aug. 31, 2012)(according to 2011 survey from McAfee, American consumers value their digital assets on average at nearly $55,000). Determining the value of digital property may be difficult. Comparables may be hard to find. Market conditions can change quickly as technology evolves and is replaced, as fads come and go, and as lifestyles change. For a person's Web pages and blogs that receive advertising revenues, those cash flows can be used to establish value. However, those cash flows may fluctuate significantly from one year to the next and may be worth little to no money if the person dies.

REPORT OF THE CHAIR, CONTINUED

I encourage all of you who are not yet engaged in committee work to join us. Get involved, come to our Quarterly meetings, join our initiatives and meet our members. If you want to learn more before you leap, call or email an officer or committee member to get advice on how to become active. We are a close but very open group we have plenty of room for those with new ideas and willing hands to help.

Although it is only fall, the year feels like time is speeding up, pushing us towards the winter holidays. In fact, the planning for this year's events is largely done and the remaining 2014 events are approaching quickly. The last few months of the year are taking shape nicely. Most notably the annual meeting will be on December 4 at the Ritz Carlton and it is free for Section members. I look forward to seeing you all there, this year and for many years to come!

continued on page 4

UFADA, CONTINUED

Even video game characters and the virtual weapons and currency used in multiplayer universe games have value.

The unique sentimental value of digital assets may be very important to the family and friends of an incapacitated or deceased person. Many people now store their photographs, diaries and letters in a computer instead of a shoebox or albums stored on a bookshelf. Family trees are created and stored in online genealogical accounts such as Ancestry.com. Blogs have replaced diaries. A decedent's life story could be lost if fiduciaries cannot access these digital assets.[6] On the flip side, access to digital assets may prevent the disclosure of secrets or hurtful information or material (affairs, addictions, etc.). By designating appropriate people to take care of or delete certain information or accounts, the person can avoid the exposure of such private details.[7]

Even when no value is involved, fiduciaries still need access to the contents of online accounts after a person becomes incapacitated or dies. Someone needs to: (1) take inventory of the person's assets; (2) pay the person's debts, taxes, and expenses; and (3) either preserve the person's property during the period of incapacity or transfer the person's property to the person's beneficiaries after death. A person's duly-appointed fiduciary has powers, duties, and authority to act on the person's behalf granted under a governing instrument (e.g., a last will and testament, a trust, or a power of attorney) and under state law. In each case, the fiduciary becomes the person's alter ego, standing in the shoes of the ward, decedent, settlor, beneficiary, etc.

Traditionally, after a person became incapacitated or died, the duly-appointed fiduciaries would go to the person's home; look through the person's paper records; and watch the person's U.S. mail for bills, account statements, and other important information needed for the administration process. If a client's bills and account statements are delivered by e-mail, and her checkbook registers and tax returns saved only in a digital format, the first challenge is finding that person's valuable or significant digital property. The second challenge is finding the passwords that allow access to those accounts and records. The third and scariest challenge for a fiduciary is the federal and state criminal and data privacy laws that pose an obstacle to reaching a beneficiary's or decedent's digital property.

Now more than ever, fiduciaries need access to an incapacitated or deceased person's electronically stored information, e-mail accounts, and other online accounts to fully accomplish their fiduciary duties to an incapacitated or deceased person. Fiduciaries often need to act quickly to meet federal and state tax filing requirements and the requirements of state courts and state fiduciary laws to promptly inventory and protect the person's property. Acting quickly is especially important for online accounts because some service providers will close the person's account and delete the person's data if the account has not been accessed for several months. In addition, federal or state criminal laws on unauthorized access to computers have a significant chilling effect on fiduciaries who may want to use the person's username and password to directly access the person's online accounts and retrieve the account contents. Clear authority for fiduciary access to online accounts and digital property is needed to keep administration costs down, to provide for a smooth administration, to avoid committing a crime, and to ensure no valuable or significant property is overlooked.

THE IMPEDIMENTS TO FIDUCIARY ACCESS

Nearly every provider of digital services has a Terms of Service Agreement (TOSA). Many users breeze by the terms of the TOSA and click "I Accept" when prompted to do so. Yahoo's TOSA lays it out plainly: "Upon receipt of a death certificate, your account may be terminated and all contents therein permanently deleted."

The cover page of the first Wall Street Journal Weekend issue of 2013 contained a lengthy report

continued on page 5

[6] Prangley, Haller & Coventry, Web of Estate Planning Considerations for Digital Assets, 40 ESTATE PLANNING 3, 4 (May 2013).

[7] *Id.* at 5.

about the family of a deceased Canadian teenager and their efforts to gain access to and control her digital legacy memorialized inside Facebook, Twitter, Tumblr, Yahoo and Hotmail accounts. None of the services would allow the family to retrieve the passwords or any other information of the deceased because it would violate the decedent's privacy. All of the companies cited their TOSA and state and federal criminal laws in support for their position.[8]

In a related matter, the United States District Court for the Northern District of California[9] prevented the estate of British fashion model Sahar Daftary in September, 2012 from compelling Facebook to turn over the decedent's Facebook account contents as part of a coroner's inquest to determine her cause of death. The court cited both Facebook's TOSA and federal electronics privacy law in arriving at its conclusion. Notably, the final sentence of the court's opinion stated, "Of course, nothing prevents Facebook from concluding on its own that Applicants have standing to consent on Sahar's behalf and providing the requested materials voluntarily."[10]

As stated several times above, federal and state privacy laws exist that criminalize the unauthorized access of computers and digital accounts. Those same laws prohibit providers of digital accounts from disclosing account information to anyone without the account holder's consent. These laws are intended to provide consumer protection against fraud and identity theft,[11] but they have a chilling effect on fiduciaries who are trying to carry out their duties of marshalling, valuation and distribution.

In 1986, Congress passed a law (the Electronic Communications Privacy Act of 1986) (ECPA) forbidding consumer electronic-communications companies from disclosing content without its owner's consent or a government order like a police warrant.[12] Until recently, courts and companies largely have interpreted this law to mean that families and fiduciaries are unable to force companies to let them access the deceased's data or their accounts. For example, e-mail accounts provided to the public by Google, Microsoft and Yahoo!, and social networking accounts provided to the public by Facebook, Google+ and MySpace, enjoy the statutory privacy protections under the ECPA.

Although a "lawful consent" exception exists in the ECPA,[13] without a law that authorizes fiduciaries to access the digital assets of a decedent or a principal, the lawful consent exception has meant that the online account service provider may choose to voluntarily disclose the contents of the electronic communications and files, but you cannot compel the service provider to disclose that information even by bringing a civil action against the service provider. The practical reality is that providers are unwilling to supply digital information to the fiduciary of an individual for fear of violating federal and state criminal law.

8 Fowler, Life and Death Online: Who Controls a Digital Legacy?, WSJ WEEKEND A1, A12 (Jan. 5-6, 2013).

9 The United States District Court for the Northern District of California is the chosen court having jurisdiction over any disputes arising under the Terms of Service Agreements for Facebook, Apple, Google, LinkedIn, Twitter, WordPress, Yahoo! and YouTube. Microsoft selected Washington State for its dispute resolution forum. Lamm, Kunz and Riehl, Digital Death: What to Do When Your Client Is Six Feet Under but His Data Is in the Cloud, 47th Annual Heckerling Institute on Estate Planning at III-E-(1)-16 (Jan. 2013) (hereinafter Lamm/Kunz/Riehl).

10 *In re Request for Order Requiring Facebook, Inc. to Produce Documents and Things,* No. C 12–80171 LHK at 3 (N.D.Cal. Sept. 20, 2012).

11 Pennsylvania's statutory law against computer hacking and unauthorized access can be found at 18 Pa. C.S.A. §§ 7601 – 7616.

12 18 U.S.C. §§ 2510 et seq. Title II of this law is known as the Stored Communications Act and contains the sections most relevant to this presentation. Id. §§ 2701 - 2712.

13 *Id.* § 2702(b)(3).

continued on page 6

UFADA, CONTINUED

THE LEGISLATIVE RESPONSE

Beginning about ten years ago, commentators started lobbying for legislation on this topic because fiduciaries were finding it necessary to have access to and control over digital property and electronic communications with increasing frequency. For example, here in Pennsylvania, State Representative Tim Briggs and 12 other Pennsylvania legislators introduced a short bill (H.B. 2580) on August 23, 2012 to amend the PEF Code to provide personal representatives with the power to take control of, conduct, continue or terminate the account of a decedent found on any social networking website, microblogging or short message service website, or e-mail service website.[14] The bill was referred to the Judiciary Committee and, as of this writing, has not been re-introduced by Representative Briggs.

Since July 2012, a group of experts across the nation has been drafting a "Uniform Fiduciary Access to Digital Assets Act" (UFADA). UFADA went through six (6) committee drafts (November 2012, April 2013, July 2013, November 2013, March 2014, July 2014) prior to its final reading and approval by the Uniform Law Commission on July 16, 2014 in Seattle.

UFADA is simple, yet comprehensive. UFADA governs only access to digital assets; the uniform law defers to other law to determine the ownership of the digital assets. Section 2 of UFADA defines certain terms of art used throughout the Act. In particular, Section 2 of UFADA introduces the reader to three people: the "account holder", the "custodian" and the "fiduciary". The "account holder" is the person who has entered into a terms-of-service agreement with a "custodian".[15] The "custodian" is the Internet service provider or other entity that carries, provides or stores a digital asset for an account holder.[16] The "fiduciary" is the person who is stepping into the shoes of the account holder because of a status recognized by state law - - an original, additional or successor personal representative, conservator/guardian, agent under power of attorney, or trustee.[17]

Another key definitions is the term "digital asset" which is defined as an "electronic record".[18] In turn, the term "electronic record" consists of two words each of which is defined in the Act: "electronic", which means technology having electrical, digital, magnetic, wireless, optical, electromagnetic or similar capabilities; and "record", which means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.[19] According to the Chair of the UFADA Drafting Committee, the term "digital asset" is intended to broadly cover all electronic or digital assets, and both the content and the catalogue of electronic communications, but the term is not intended to include any underlying assets or liabilities that are not, themselves, digital.[20]

[14] The proposed Pennsylvania statute is virtually identical to similar statutes that were enacted in Oklahoma (Okla. Stat. §58-269)(2010)) and Idaho (Idaho Code §15-3-715(28)(2011)). Other states with laws that begin to address the issues are Connecticut (Conn. Gen. Stat. § 45a-334a)(2005)), Rhode Island (R.I. Gen. Laws ch. 33-27)(2007)), Indiana (Ind. Code § 29-1-13-1.1)(2007)), Nevada (Nev. Rev. Stat. ch. 143 (2011)) and Virginia (Va. Code §64.2-110 (2012)).

[15] UFADA § 2(1)(A).

[16] *Id*. § 2(8).

[17] *Id*. § 2(13). See id. § 2(1)(B)(term "account holder" includes the fiduciary for a person who has entered into a TOSA).

[18] *Id*. § 2(9).

[19] *Id*. §§ 2(10), (21).

[20] Walsh, Memorandum to Committee of the Whole, 2014 ULC Annual Meeting at 2 (May 27, 2014)(hereinafter Walsh)("Thus, a digital asset includes a virtual currency, but not a tangible asset such as gold bullion). See also Official Comments to UFADA § 2 ("The fiduciary's access to a record defined as a 'digital asset' does not mean that the fiduciary is entitled to 'own' the asset or otherwise engage in transactions with the asset.").

continued on page 7

UFADA, CONTINUED

FIDUCIARY ACCESS

Following the Definitions Section, Sections 3 through 6 of the Act separately address the authority of each fiduciary contemplated by the Act: personal representatives, conservators and guardians,[21] agents under powers of attorney, and trustees. Sections 3 and 4 govern the authority of the two types of court-appointed fiduciaries (personal representatives and guardians); Sections 5 and 6 govern the other two types of fiduciaries to whom access to digital assets may be explicitly granted by an account holder (agents and trustees).

Section 3 of the Act provides that the personal representative of a deceased account holder may access: 1) the content of an electronic communication sent or received by the decedent but ONLY IF the electronic-communication service or remote-computing service is permitted to disclose the content under Federal law; 2) the catalogue of electronic communications sent or received by the decedent; and 3) any other digital asset in which the decedent at death had a right or interest.[22]

The drafters of UFADA paid close attention to Section 2702 of the Electronic Communications Privacy Act (ECPA).[23] As discussed briefly in an earlier section, Federal law distinguishes between the permissible disclosure of the "content" of an electronic communication and of records or other information pertaining to an account holder. Content-based material is further distinguished between communications received by the account holder and communications sent by the account holder.[24] Material addressed to the account holder can be disclosed to the account holder or to an agent for the account holder under Section 2702(b)(1) of the ECPA, and that content also can be disclosed to third parties with the "lawful consent" of the account holder under Section 2702(b)(3) of the ECPA. Material for which the account holder is the originator, however, can be disclosed to third parties only with the account holder's lawful consent. In contrast, non-content based material (e.g., the "catalogue of electronic communications" as that term is defined in UFADA Section 2(3)) can be disclosed with either the lawful consent of the account holder or to any person even without the lawful consent of the account holder.[25]

The concepts are the same when it comes to fiduciary access by guardians, but the gateway to fiduciary access is different. Section 4 of UFADA states that a guardian may access digital assets only via judicial authorization after an opportunity for hearing under the applicable state law.[26] Beyond the requirement of specific court authority, Section 4 is virtually identical to Section 3 governing access by personal representatives.

Section 5 of UFADA covers access to digital assets by agents under powers of attorney. This section establishes an important distinction to be noted by attorneys drafting powers of attorney for their clients.

21 Although the term "guardian" never appears in UFADA, the definition of "conservator" under UFADA is "a person appointed by a court to manage the estate of a living individual." UFADA § 2(5). Furthermore, wherever the term "conservator" appears in UFADA, the term is surrounded by brackets thus indicating the Drafting Committee's understanding that one state's conservator is another state's guardian. See Legislative Note to UFADA § 2 ("States should insert the appropriate term for a conservatorship or comparable state proceeding in subsection (5) … ."). This Pennsylvania-centric presentation will use the term "guardian" instead of "conservator".

22 UFADA § 3.

23 18 U.S.C. § 2702. *See* supra notes 7 & 8.

24 Official Comments to UFADA § 3.

25 *Id*.

26 UFADA § 4.

continued on page 8

UFADA, CONTINUED

UFADA states that an agent has default authority over all of the account holder's digital assets OTHER THAN the content of the account holder's electronic communications. If the account holder does not want his or her agent to exercise authority over non-content based electronic communications, the power of attorney must contain express language preventing an agent from having access to the account holder's digital assets.[27] In contrast, in order for an agent to have access to the content of an account holder's electronic communication, the account holder must specify in her or his power of attorney that the agent has authority to access the content of the principal's electronic communications.[28] In this manner, an account holder's power of attorney should constitute "lawful consent" under the ECPA.

Finally, Section 6 of UFADA covers access to digital assets by trustees. This section of the law distinguishes between trustees who are the "original account holder" and trustees who become a "successor account holder". Where the trustee opens an account with a custodian and enters into the service provider's TOSA, the trustee in that case has legal title to the digital asset and thus access to both the catalogue and the content of electronic communications is presumed. In other words, unlimited access to digital assets held in trust is presumed with respect to assets for which the trustee is the original account holder.[29]

More frequently, however, the situation will involve a settlor transferring a digital asset into a trust or a transfer by means of a pourover Will of a digital asset into the trust. Where a digital asset owned by someone else is transferred into a trust, the trustee in that case is not the original account holder.[30] The Official Comments to UFADA Section 6 opine that "[t]here should be no question that the trustee with legal title to the digital asset was authorized by the settlor to access the digital assets so transferred, including both the catalogue and content of an electronic communication, and this provides 'lawful consent' to allow disclosure of the content of an electronic communication from an electronic communication service or a remote-computing service." Section 6 nevertheless maintains the distinction between the catalogue and the content of an electronic communication in cases involving successor account holders in the event any questions arise about whether the transaction involving the property held in trust constitutes lawful consent.[31]

FIDUCIARY AUTHORITY, COMPLIANCE AND CUSTODIAN IMMUNITY

The heart of UFADA is found in Section 7, entitled "Fiduciary Authority". This section contains the procedures governing and delineating the nature of fiduciary access to digital assets. Section 7 sets forth the proposition that the fiduciary has the same authority as the account holder if the account holder were the one exercising the authority. In other words, fiduciaries step into the shoes of account holders and thereby have the same, but no greater, access and rights to digital accounts and assets as the account holder does under the service provider's TOSA. The fiduciary is presumed to have the lawful consent of the account holder under the ECPA.[32]

But Section 7 goes even further. Section 7(d) of UFADA states that any provision of the agreement

[27] *Id*. § 5.

[28] *Id*.

[29] *Id*. § 6(1).

[30] *Id*. § 6(2).

[31] Official Comments to UFADA § 6.

[32] UFADA § 7(a)(2).

continued on page 9

UFADA, CONTINUED

limiting third-party access or requiring notice of change in the account holder's status may not be enforced to bar fiduciary access, and Section 7(c) of UFADA states that any choice of law provision that has the effect of limiting a fiduciary's access to digital assets is unenforceable. Finally, Section 7(b) flatly states that any provision of a TOSA that limits a fiduciary's access to the digital assets is void as against the strong public policy of applicable state law UNLESS the account holder affirmatively agrees to such a provision by means of an act of independent significance separate and apart from the account holder's general assent to the other provisions of the TOSA.[33]

The Comments to Section 7 contain five "Examples" illustrating how the principles of UFADA should apply in situations involving access to digital assets by 1) personal representatives, 2) guardians, 3) agents under a power of attorney, 4) trustees, and 5) any fiduciary where the express provisions of a service provider's TOSA are contrary to UFADA.[34]
To reinforce matters, Section 8 of UFADA states that a custodian "shall comply" with a properly supported request to access to digital assets by a fiduciary.[35] The use of the mandatory verb form "shall" was a deliberate choice by the drafting committee.[36] The Act gives the custodian 60 days to comply with the request by the fiduciary for access to the digital asset, control of the digital asset and a copy of the digital asset (to the extent permitted by copyright law).

Finally, Section 9 of UFADA grants immunity to custodians who act in good faith in compliance with UFADA.[37] The Act notably does not require fiduciaries to indemnify and hold custodians harmless from all civil and criminal actions when the custodian complies with a mandatory request for access. Again, the drafting committee considered and rejected that more broad exculpation of custodians and internet service providers.[38]

PLANNING CONSIDERATIONS

UFADA is brand new. As of this writing, UFADA has been adopted by only one state (Delaware). Advance planning with our clients and beneficiaries therefore is still important, and it will continue to be important even if UFADA is adopted by all 50 states and the District of Columbia. Consequently, some common sense rules should be adopted by you and your clients.

1. Have your clients prepare a complete list of passwords, online accounts and other digital property.

2. Have accessible backups of valuable or significant electronically-stored information. Locating digital property can take a significant amount of time and effort to find and gain access. Valuable digital property may be overlooked or may be inaccessible.

3. Passwords are an obstacle to fiduciary access.[39] Most service providers won't reveal or reset an incapacitated or deceased person's password, ever for a duly-appointed guardian, conservator, executor, trustee or agent acting under a power of attorney. Computer security and computer forensics experts are expensive. Even with expert help, however, digital property protected by strong passwords plus strong encryption

[33] *Id*. § 7(b) – (d).

[34] Official Comments to UFADA § 7.

[35] UFADA § 8.

[36] Walsh, supra note 20, at page 3.

[37] UFADA § 9.

[38] Walsh, *id*.

[39] Passwords are supposed to be an obstacle to unauthorized access. Clifford Stoll is reputed to have said, "Treat your password like your toothbrush. Don't let anybody else use it, and get a new one every six months." Fiduciaries, of course, are not unauthorized users.

continued on page 10

may be practically impossible to access. Consequently, without knowing the passwords, a person's fiduciaries and family members may not be able to fully access a person's smartphone, computer, online account, or electronically stored information.

4. Conduct a digital fire drill with your clients. Ask your client: if your computer is lost, stolen or destroyed in a fire, flood, tornado or hurricane today, what valuable or significant digital property would you lose? Similarly, if you were in an accident today or died today, how would your family and fiduciaries access your valuable or significant digital property?

5. Minnesota Attorney Jim Lamm is one of the most savvy commentators on this evolving area of our practice. He has prepared a template for use as a "Digital Audit". You can download a copy of the template at http:/www.digitalpassing.com/digitalaudit.pdf.

6. Written lists are inherently insecure: advise your client to store their password lists in a safe deposit box, home safe or with their attorney. Passwords require frequent updating, however, and frequent updates don't work well with written lists. Electronic methods of storage probably are preferable to just a written list. An electronic list of passwords can be kept on a client's smartphone, computer, zip drive or Web site. Free and commercial software is available to keep track of passwords, and popular software or Web-based services to keep electronic lists of accounts and passwords include LastPass, 1Password, KeePass, RoboForm and Keeper.[40]

7. Web-based services such as AfterSteps, AssetLock, Deathswitch, EstateLogic, Estate++, EZ Safe LegacyLocker, MyInternetData, SecureSafe and World Without Me can store an electronic list of passwords, online account information and other digital property and also provide a mechanism for authorized fiduciaries or family members to access the list. The client tells the company in advance which key people can unlock this information at the appropriate time and, after being contacted by that fiduciary or family member, the company will grant access after a verification procedure. Some of these companies take a proactive approach – contacting the person on a regular basis to make sure the person is still alive and not incapacitated; if no response is received within the prearranged time limit, the company will send an automatic e-mail message with the person's important information to the designated family members, fiduciaries, and advisors.[41]

8. Google supports a program called "Inactive Account Manager" that lets users decide exactly how they want to deal with the data they've stored online with the company. The user advises Google which people should be notified when the company deactivates the account. Users are allowed up to 10 names and choices of when to end the account (e.g., after 3, 6 or 9 months of electronic silence). One month before account de-activation, Google notifies those to whom you have authorized access and provides links they can follow to download the photographs, videos, documents or other data.[42]

9. Make sure your clients back up their data. Valuable or significant data stored online should be regularly backed-up to local storage media. To locally back up an online e-mail account, clients should use an e-mail application installed on their personal computer. For example, Mozilla Thunderbird is a free e-mail application available for Microsoft Windows, Apple Mac OS and Linux-based computer systems. Facebook or Google+ social networking accounts can be downloaded in to a single archive from the account settlings page. A

[40] Lamm/Kunz/Riehl, supra note 9, at III-E-(1)-18.

[41] *Id.*

[42] Eisenberg, Bequeathing the Keys to Your Digital Afterlife, THE NEW YORK TIMES ONLINE at 20 (May 26, 2013).

continued on page 11

JOIN A COMMITTEE

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

Karen M. Stockmal, Esq.

KMS LAW

1055 Westlakes Drive, Suite 300

Berwyn, PA 19312

karen.stockmal@kmslawoffices.com

UFADA, CONTINUED

Web-based service called Backupify will automatically create periodic backups of a client's electronically stored information at Facebook, Twitter, Google Gmail, Flicker, Picasa, LindkedIn, Blogger, etc.[43]

10. The list of valuable or significant digital assets is lengthy and changes almost daily. Here's a partial list of the stuff to look for: home security systems, voicemail accounts and answering machines, smartphones and computers, e-mail accounts, financial information and accounts such as Quicken, QuickBooks, TurboTax, Mint.com and Bundle.com, online purchase and sale accounts such as eBay, CraigsList, Amazon.com, PayPal and WesternUnion, Web pages and blogs, social networking accounts, domain names, digital music, videos, photos, audiobooks, e-books, apps and other media, intellectual property rights such as copyrighted materials, video games and virtual worlds such as World of Warcraft, Final Fantasy, Runescape, Planet Calypso, etc.,[44] and online storage accounts such as Amazon Cloud Drive, Apple iCloud, Box.net, Carbonite, Dropbox, Microsoft Live SkyDrive, SpiderOak, SugarSync and Wuala.

[43] *Id*. at 20-21.

[44] $20.77 billion of worldwide sales in 2012; approximately six computer or video games sold every second in 2012.

LIVE SEMINAR

Scott S. Small, JD, Trisha W. Hall, Esq., and Prof. Michael V. Risch are conducting a live seminar titled "We Are Living (and Dying) in a Digital World: Estate Planning for Digital Assets and Accounts" on October 7, 2014 at 12:30 pm.

To register:

http://www.legalspan.com/pbi/catalog.asp?UGUID=&CategoryID=20020903110249133627&ItemID=20140806-229194-102257

TAX UPDATE

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

FEDERAL ESTATE TAX

RELIANCE ON TAX EXPERT'S ADVICE

Estate of Thouron v. U.S. 2014 U.S. App. LEXIS 8890 (3d Cir. Pa. 2014) (May 13, 2014)

The Third Circuit ruled that reliance on a tax expert can be considered reasonable cause under Treas. Reg. § 301.6651-1(c)(1) for late payment of taxes if the taxpayer can also show either an inability to pay or undue hardship from paying on time.

The Court overturned a District Court ruling that the IRS was barred from refunding a penalty imposed on an estate. The penalty was caused by the erroneous advice of an attorney that led the estate to not timely seek an extension for the payment of federal estate taxes.

The executor of the estate had retained an experienced tax attorney. The estate requested a six-month extension on the due date of the Federal Estate Tax return and made a significant monetary payment that was less than the estate owed. It did not request an extension of time to pay or pay the balance of its liability because the attorney had not yet decided whether a § 6166 election was appropriate. The estate timely filed the extended return but requested another extension of time to pay. The IRS imposed a failure to pay penalty, to which the estate objected because it claimed that the failure to pay resulted from reasonable cause. For a taxpayer to show that the failure to pay is due to reasonable cause, the taxpayer must prove that s/he exercised ordinary business judgment and either of the following was true: the taxpayer was unable to pay on that date, or undue hardship would result from the payment of the taxes on that date.

The District Court, citing *Boyle*, 1985 (U.S.) 55 AFTR 2d 85-1535, had stated that reliance on an expert was not reasonable cause for late payment. The Third Circuit, however, determined that in this case, the failure to pay arising out of reliance on the advice of a tax expert could be considered reasonable cause if it was accompanied by inability to pay or undue hardship. It remanded the case back to the District Court to decide whether either inability to pay or undue hardship was present.

FAILURE TO FILE PENALTY

Liftin v. U.S., 2013-5103 (U.S.C.A., Federal Cir.) (June 10, 2014)

The U.S. Court of Appeals affirmed the lower court's finding that a twenty-five percent failure-to-file penalty was mandatory when an estate which filed IRS Form 706 two years after the extended due date was unsuccessful in demonstrating that it had reasonably relied on the advice of a tax professional.

The executor, who was an attorney and the son of the decedent, obtained legal advice from his former law partner on two issues: whether the estate could take the marital deduction only if the decedent's wife became a U.S. citizen before filing the federal estate tax return, and matters related to litigation concerning a prenuptial agreement signed by the decedent and his wife. Both matters were unresolved as of the extended due date of the return. Before the deadline the executor made an estimate payment to the IRS of an amount sufficient to cover the estate tax even if the marital deduction were not taken. The estate did not file the tax return, relying on the advice of the former law partner that the return could be filed after the open issues were resolved.

The former law partner advised the IRS by letter that the estate was waiting to file the return until the decedent's wife obtained U.S. citizenship. The letter did not mention the second issue. Even after the wife obtained U.S. citizenship, the executor did not file the return for an additional nine months.

The IRS assessed a late-filing penalty, which the executor contested in the Court of Federal Claims. The

continued on page 13

court held that the estate's failure to file up to the date of citizenship was due to reasonable cause under IRC § 6651(a)(1), i.e. reliance on the advice of the former law partner. But it found that the estate lacked reasonable cause for the additional nine-month delay in filing. The Court of Appeals agreed with the lower court.

In a detailed dissent, Circuit Judge Pauline Newman argued that, under IRC § 6651(b), the combination of the estimated taxes paid by the estate, which resulted in an overpayment of taxes due, and the estate's letter to the IRS concerning the remaining issues should have averted the imposition of the late-filing penalty.

ESTATE TAX REFUND

Estate of Donald McNeely v. U.S. (D. Minn. June 12, 2014)

The District Court granted summary judgment to the IRS in ruling that the IRS may apply tax payments to outstanding liabilities even if the taxpayer has made an election for deferral.

The Estate filed a request to extend the filing deadline, while making an estimated federal estate tax payment of about $2.5 million. It included a letter with the tax payment to inform the IRS of its intention to make a § 6166 election to defer the payment of tax due on the closely held business interests held by the estate and requesting that the IRS apply the estimated payment only to the non-deferred portion of the estate tax.

When the Estate filed its return, it sought a refund of about $2.0 million, representing the difference between the estimated payment and the portion of the estate tax that was not related to the decedent's closely held business interests. The IRS denied the request for a refund and stated that the $2.0 million "overpayment" would be applied to the installments due under the Section 6166 election.

The Estate filed a refund suit. The Court ruled that, under IRC § 6402 and § 6403, the IRS had discretion to credit the overpayment to the outstanding tax liability, regardless of the taxpayer's request and regardless of the § 6166 election.

VALUATION

Estate of Bernard Kessel, T.C. Memo. 2014-97 (May 21, 2014)

The Tax Court denied a motion for summary judgment by the IRS concerning the valuation for estate tax purposes of an investment account managed by Bernie Madoff's firm.

The decedent invested a personal pension plan with the Madoff firm in 1992 and died in July, 2006. On the estate tax return, which was filed in 2007, the value of the plan's account was reported as $4.8 million. The executor paid about $2.3 million in estate tax. Between 2006 and 2008, when Madoff was arrested, the beneficiaries made about $2.8 million in withdrawals from the account. Discovering that it was unable to recover the remaining assets in the account, which Madoff reported to be about $3.2 million, the estate filed Form 843, Claim for Refund and Request for Abatement, seeking an estate tax refund of $1.9 million. The IRS denied the request. The estate petitioned the Tax Court, claiming that the value of the account was zero.

The IRS moved for partial summary judgment, requesting that the Court rule that must be valued for federal estate tax purposes was the Madoff account, not its actual holdings. It also asked the Court to rule that there was no way for a hypothetical willing buyer/willing seller of the account would not know that the Madoff account was a Ponzi scheme. The Court denied both motions because it could not determine which property interests should be valued without a trial to develop the facts.

Estate of Adell v. Commissioner, T.C. Memo. 2014-155 (Aug. 4, 2014)

The Tax Court prohibited an estate from amending its return and entering a lower value than had originally been determined. In its discussion, it rejected an asset-based valuation approach for a decedent's stock holdings and adopted instead a discounted cash flow method that employs an economic charge for the non-transferable goodwill of a key employee.

continued on page 14

TAX UPDATE, CONTINUED

The decedent died in 2006, leaving stock in his solely owned corporation, STN, that was held in trust. The question before the Court was the value of the stock. The court considered various valuation methods, including (a) discounted cash flow with a weighted average rate of return of 20 percent and an economic charge of between 37 and 44 percent of sales for the personal goodwill of the employee who was responsible for the corporation's success, which resulted in a valuation of $9.3 million; (b) adjusted book value, which resulted in a valuation of $4.3 million; and (c) discounted cash flow with no personal goodwill economic charge, the valuation proposed by the IRS, which resulted in a valuation of $23.3 million.

The Court rejected the asset-based valuations because they falsely indicated that the company was not profitable. It also rejected the IRS's valuation because it conflated the goodwill of the corporation with the goodwill of the key employee. In adopting method (a) above, it showed how non-transferrable personal goodwill could effectively lower taxable value.

FEDERAL GIFT TAX

Mandatory Penalties for Late Returns

Estate of Adell v. Commissioner, T.C. Memo 2014-89 (May 15, 2014)

As in *Estate of Donald McNeely v. U.S.* (D. Minn. June 12, 2014) (discussed above), the Tax Court ruled that, where overpayments of the non-deferrable portion of federal estate tax due under a § 6166 election were made, none of the overpayment was available as a credit against an estate's unpaid federal gift tax liability when the estate tax liability has not been paid in full.

STATUTE OF LIMITATIONS

Estate of Sanders v. Commissioner, T.C. Memo, 2014-100; No. 14489-12 (May 26, 2014)

The Tax Court denied the Estate's request for partial summary judgment and ruled that the statute of limitations had not been triggered by the gift tax returns filed by the decedent.

In 2012, the IRS audited the estate of the decedent, who had died in 2008. As a result of the audit, the IRS assessed an increase in the taxable gifts of $3.2 million. The estate argued that the three-year statute of limitations for the assessment of gift tax had run.

The issue in this case was whether the decedent had made sufficiently adequate disclosure on the gift tax returns as to commence the three-year limitations period. The decedent had made gifts of shares of stock in the family farm supply distribution company every year from 1999 through 2008 and filed contemporaneous gift tax returns. However, the returns failed to disclose a subsidiary that was a closely held entity. The Court held that by failing to make this disclosure, which is required under Reg. 301-6501(c)-1(f)(2)(iv), the decedent had failed to "adequate[ly] apprise the Secretary of the nature of the gift" under IRC § 6501(c)(9). Therefore, the statute of limitations had not expired before the gift tax assessment notices were sent by the IRS.

RECENT U.S. SUPREME COURT DECISION ON INHERITED IRAS IN BANKRUPTCY

BY ROBERT H. LOUIS, ESQUIRE | SAUL EWING LLP

The recent decision of the U.S. Supreme Court in *Clark v. Rameker*, 573 U.S. _____, 134 S. Ct. 2242 (2014) resolves a dispute in the lower courts about the status of inherited IRAs under federal bankruptcy law. Although the decision is likely to affect only a small number of clients, it highlights, for trust and estates practitioners, some essential points:

1. The unique aspects of retirement plan accounts and individual retirement accounts as assets passing between generations;

2. The variety of techniques that may be used in the transfer of these assets;

3. The importance of understanding the financial needs and the financial acumen of potential beneficiaries; and

4. The value of preserving some level of flexibility until after the retirement account owner's or IRA owner's death.

In this decision, a unanimous Supreme Court ruled that certain inherited IRAs (those passing to a nonspouse beneficiary after the owner has died) are not entitled to an exemption for retirement accounts under federal bankruptcy law. Although the decision to this effect was unanimous, the logic of the case is not so compelling that a contrary result could not be imagined. The Court focused on three aspects of inherited IRAs that distinguished them from IRAs owned by the person who established them, and that resulted in the loss of the federal exemption:

- the owner of the inherited IRA cannot add to the account;

- the owner of the inherited IRA must begin taking minimum distributions soon after inheriting the IRA, even though the new owner might be far from a customary retirement age; and

- the owner of the inherited IRA may withdraw from it without penalty at any time, while the original owner might be subject to a penalty for withdrawals before age 59½.

For these reasons, the Court decided that the inherited IRA was merely a "pot" of money and not really a retirement fund. The ruling specifically referred to a nonspouse beneficiary, and therefore does not necessarily apply to a spouse who obtains ownership of the IRA after the original owner's death. Spouses have more options regarding an IRA than do nonspouses, including the ability to convert it into the spouse's own IRA. By doing so, the spouse may name beneficiaries for any amount not withdrawn at the spouse's death, who will be entitled to withdraw the balance, in turn, over their life expectancies. However, the spouse is not required to do this, and may retain the IRA as an inherited one; and in fact may convert the IRA to his or her own long after inheriting it. Some commentators have questioned whether IRAs inherited by spouses are truly distinct from those inherited by nonspouse beneficiaries, or might be challenged in future litigation; particularly if the spouse does not convert until shortly before filing for bankruptcy.

This decision leaves the owners of inherited IRAs with the alternative of opting for state exemptions for retirement plan and IRA assets, which are not affected by this decision. Unfortunately, state exemptions for inherited IRAs exist in only these states: Alaska, Arizona, Florida, Indiana, Missouri, North Carolina, Ohio, South Carolina and Texas. A few other states have statutory language that might be helpful, but Pennsylvania is not among them. Further, for planning purposes, the state exemptions might not be very helpful, because the state law that is relevant is where the person filing for bankruptcy has been domiciled long enough to take advantage of the exemption, not where the decedent lived or where the IRA was set up. And in our mobile society, knowing where the IRA beneficiary lives at the time the beneficiary designation is made might not be especially useful information.

continued on page 17

INHERITED IRAS IN BANKRUPTCY, CONTINUED

What effect does this decision have on advice to clients who are deciding how to pass IRA ownership? It is unlikely that clients will know whether a beneficiary is going to declare bankruptcy at some future date, and where that beneficiary will be living at the time. At most, clients will have an opinion about the financial acumen of beneficiaries; and this, rather than a specific ruling about bankruptcy, will be of greater value in deciding how to designate beneficiaries. It might be of greater importance to know which states provide creditor protection outside of bankruptcy. Pennsylvania is one of them, although to a lesser extent than the protection afforded to qualified retirement plans under federal law.

In the typical case, a client who owns an IRA will be pleased to have the opportunity to have some flexibility in determining how IRA benefits are to be distributed. This will usually take the form of naming the surviving spouse as the primary beneficiary of the IRA, to receive or withdraw the proceeds outright. (This is sometimes departed from in the case of a second marriage where children from the first marriage are intended to be the ultimate beneficiaries after the death of the surviving spouse.) The secondary beneficiary is often a trust under the will of the decedent, although a trust established by the decedent during life will also serve. Under that trust, the spouse might be entitled to benefits during life, with the balance passing to someone's children thereafter. The flexibility arises because to the extent the spouse does not need or want the benefits outright, they maybe disclaimed to the trust; and, if desired, the spouse may disclaim the trust benefits as well. So, in this type of planning, what is the significance of the Supreme Court's decision? Practically none, unless the original IRA owner knows that a beneficiary is likely to file for bankruptcy shortly after the owner's death. More important is a careful examination of the spouse's financial situation and acumen, the likelihood that the spouse might, if named the beneficiary, do something with the IRA assets contrary to the wishes of the original owners, and the financial information or opinions the IRA owner has regarding the subsequent beneficiaries. Naming a trust that contains a spendthrift provision as the beneficiary can mitigate the problems under federal bankruptcy law, and that might be the appropriate solution, after a thorough discussion with the client of all of the financial issues facing the family. The value of *Clark v. Rameker* to planners is to reinforce the need for collecting extensive information about the entire range of retirement assets owned by a client and the risks facing those retirement assets, based upon the history and prospects of the client's family. In short, not just because of this decision, planners need to have a clear understanding of the extent of retirement assets, how they are taxed, how they may be transferred to beneficiaries, and what risks and opportunities arise from those transfer options.

People who know, know BDO.SM
For more than 100 years, BDO has provided quality service through the active involvement of experienced and committed professionals. The firm serves clients through 49 offices and over 400 independent alliance firm locations nationwide. As an independent Member Firm of BDO International Limited, BDO serves multinational clients through a global network of 1,264 offices in 144 countries.
MADELINE JANOWSKI, CPA
mjanowski@bdo.com
BDO
1700 Market Street, 29th Floor
Philadelphia, PA 19103
215-636-5500
Accountants and Consultants
www.bdo.com
BDO

THE FRANK ARAGONA TRUST CASE: MATERIAL PARTICIPATION BY ESTATES AND TRUSTS

BY WAYNE R. STRASBAUGH, ESQUIRE | BALLARD SPAHR LLP

As part of its massive 1986 tax reform legislation, Congress enacted the "passive activity loss" (PAL) limitations of Section 469 of the Internal Revenue Code to put a stop to the individual tax shelters that had proliferated since the 1960's. The authors of this legislation did not pay much attention as to how the PAL limitations would apply to fiduciary taxpayers, leaving that issue to be sorted out by IRS regulations. Since 1992, a section of the Section 469 regulations has in fact been specially reserved to deal with the application of the PAL limitations to fiduciary taxpayers but with no movement toward the adoption (or even proposal) of regulations that might provide guidance. The recent Tax Court decision of *Frank Aragona Trust v. Commissioner,* 142 T.C. ___, No. 9, (Mar. 27, 2014) addresses one of the issues that has troubled fiduciary taxpayers in determining whether losses from business operations are allowable in their returns but also indicates how much more guidance is needed.

In order to avoid the PAL limitation, a taxpayer must "materially participate" in the business activity that gives rise to the loss. A brief sentence in the legislative history indicates that the participation in the activity by a fiduciary "in his capacity as such" is determinative of the extent of an estate or trust's participation. The IRS has announced in technical advice that this standard requires the duties of the fiduciary expressed in the trust instrument to include the operation of the business. Participation by a person involved in the business who happens also to serve as a fiduciary will not, in the IRS view, count as participation by the estate or trust entity. In *Mattie K. Carter Trust v. U.S.*, 256 F.Supp.2d 536 (N.D. Tex. 2003), however, a court held that the participation of a trust should be determined by the activities of its trustees, employees and agents in running the business and not only by those of its trustees.

Carter involved material participation in the operation of a ranch business. By contrast, *Aragona* involved a more complex inquiry of material participation under the real estate professional exception in Section 469(c)(7), a provision that Congress added in 1993 as a sop for increasing tax rates. In brief, Section 469(c)(7) permits certain taxpayers to treat deductions arising from the per se passive activity of real estate leasing as non-passive (and thereof allowable) if (i) more than one-half of the personal services performed in trades or businesses by the taxpayer during the taxable year are performed in real property trades or businesses in which the taxpayer materially participates, and (ii) the taxpayer performs more than 750 hours of services during the taxable year in real property trades or businesses in which the taxpayer materially participates. If this two-prong test is satisfied, then the taxpayer's rental real estate activities will not be treated as per se passive but will be separately evaluated under the material participation standard.

In rejecting IRS arguments that a residuary trust was ineligible for the real estate professional exception, *Aragona* essentially addressed only part of the statutory requirement. First, the court determined that a trust was capable of performing "personal services," though not a natural person. Second, the court agreed with *Carter* that the activities of trustees could be considered in determining the trust's material participation. Specifically, *Aragona* held that the activities of some trustees as employees of a management company wholly-owned by the trust (and a disregarded entity for tax purposes) could be taken into account. Because the participation of these trustees was sufficiently material, the court declined to address the statutory relevance of the activities of non-trustee employees of the management company.

Moreover, *Aragona* did not attempt to reconcile its finding that the trust materially participated on the basis of these employees' services with the statutory language in Section 469(c)(7)(D)(ii) that personal services

continued on page 20

ARAGONA, CONTINUED

performed as an employee could not be treated as performed in real property trades of business for purposes of the "more than half" and 750-hour tests. The IRS failed to preserve this matter as an issue for decision in the course of the litigation. Even if this bar were somehow lifted for the trust (perhaps on the grounds that the entity itself was not an employee), it would remain unclear how these quantitative tests should be applied. Should the "more than half" test, for example, be measured by reference to all personal services performed by the trustees – even those personal services performed by those fiduciaries with no connection to the real estate businesses?

The IRS also failed to preserve the issue of whether the trust materially participated in any or all of its rental estate activities, leading the court to conclude that all of the trust's rental real estate activities were not passive by default. This IRS concession was costly in view of its litigation position that the tests for material participation in real estate trades or businesses (Section 469(c)(7) and for material participation in specific real estate activities are distinct inquiries. In another case, resolution of this issue could be determinative of whether a trust could benefit from the real estate professional exception.

Treas. Reg. Sec. 1.469-9(b)(5) states that material participation for purposes of the real estate professional exception has the same meaning as the basic material participation standard for lifting the PAL limitation on business deductions generally. Section 469(c)(7)(A) (flush language) permits a taxpayer to aggregate all of its rental real estate activities for purposes of determining its material participation under requirement (ii) of Section 469(c)(7)(B)(ii). However, as emphasized in a legal memorandum written after the *Aragona* decision, ILM 201427016 (Apr. 28, 2014), a taxpayer that fails to make the Section 469(c)(7)(A) election is required to evaluate its material participation in each rental real estate property for purposes of claiming allowable deductions under Section 469(c)(7)(B)(ii), notwithstanding the aggregation of all its real estate activities (leasing and developmental) for purposes of Section 469(c)(7)(B)(i). The Section 469(c)(7)(A) election (or non-election) is therefore a trap for the unwary, particularly for fiduciaries that may have filed returns without recognizing their trusts' potential eligibility for the real estate professional exception.

Because of the factual and procedural limitations on its holdings under Section 469(c)(7), *Aragona* may be more helpful as authority for estates and trusts that have received interests in non-real estate businesses than for those engaged in real estate activities. Taken in combination with *Carter*, the court's holding that a trust's material participation may be determined through the business activities of its trustees and employees (including activities that may not be expressly required under the fiduciary instrument) will make it difficult for the IRS to sustain its more restrictive interpretation of the statute in future cases.

Finally, it should be noted that the stakes involved in the resolution of this legal issue have risen on account of the enactment of the excise tax on net investment income. By reason of Section 1411((c)(2)(A), the base for this tax includes income from a trade or business that is a "passive activity." Both the statutory language and the regulations issued under Section 1411 make it clear that a business's status as a passive activity is to be determined under the Section 469 regulations, notwithstanding the totally different purposes of the two provisions. In response to pleas of tax advisers that the Section 1411 regulations should (finally) address the issue of material participation by an estate or trust, the IRS in the preamble to Treasury Decision 9644 (Nov. 26, 2013) noted only that "the commentators have raised valid concerns."

PRACTICE POINTS

BY BERNICE J. KOPLIN, ESQUIRE | SCHACHTEL, GERSTLEY, LEVINE & KOPLIN, P.C. |
WILLIAM M. LABKOFF, ESQUIRE | LAW OFFICES OF WILLIAM M. LABKOFF

This Practice Point is intended to bring to the readers' attention that Petitions for Allowance should be filed in the Orphans' Court Division, pursuant to Joint General Court Regulation Trial Division and Orphans' Court Division No. 97-1 ("Joint Court Regulation 97-1"), thus complying with Joint Court Regulation 97-1 and avoiding extra time, effort and cost. The authors of this Practice Point have become aware that some attorneys file Petitions for Allowance in the Trial Division, filing a Motion Package for a Miscellaneous Motion - (code MTMIS) and paying a (current) filing fee of $58.50. In Trial Division, such attorneys have been be able to accelerate the Court's response (generally the Trial Division requires a 20 day notice period for motions) by calling the legal clerk in the office of the Administrative Judge when they have received the e-mail notice that their Petition filed in Motion Court has been "accepted," and the legal clerk will retrieve the motion package and forward it to the appropriate Orphans' Court Judge.

The local Philadelphia rules, procedures and forms for obtaining approval for litigation settlements involving minors, incapacitated persons or wrongful death and survival actions are contained in Joint Court Regulation 97-1, and Local Phila. R. Civ. P. Nos. 2039.1, 2039.2 and 2206. Joint Court Regulation 97-1 specifically states that to the extent that local rules 2039.1, 2039.2 and 2206 differ from the terms of Joint Court Regulation 97-1, Joint Court Regulation 97-1 governs and the contrary provisions of the local rules wee rescinded.

When a Minor's Compromise has been filed through the Trial Division, and thereafter a Petition for Allowance is to be filed, the procedure is that mandated in General Court Regulation 97-1:

> *III. Petitions for Allowance*
>
> *(a) Petitions for Allowance in those cases where a guardian has been appointed by the Orphans' Court Division of Philadelphia County shall be filed directly with such Division. A copy of the Order approving the settlement shall be attached to the Petition.*
>
> *(b) Petitions for Allowance in those cases where a guardian has been appointed by the Orphans' Court Division of a county other than Philadelphia, or by a different state, shall be filed directly with such appointing Court. A copy of the Order approving the settlement shall be attached to the Petition.*
>
> *(c) Petitions for Allowance in those cases where a guardian has not been appointed shall be filed with the Orphans' Court Division of the appropriate county or other state. A copy of the Order approving the settlement shall be attached to the Petition.*

Joint Court Regulation 97-1 states that petitions for allowance shall be filed in Orphans' Court Division. If the matter had never been assigned an Orphans' Court number, an Orphans' Court number will be assigned at the time of filing the Petition for Allowance, as a First Filing. The Regulation requires that a copy of the Order approving the settlement be attached to the Petition; this allows the Orphans' Court Division Judge to understand the matter without obtaining any further court records, while complying with the requirements. It is also important to simultaneously follow the requirements of Orphans Court local rule Rule 12.5.C. [Minor's Estate. Restricted Account] regarding the contents of the Petition for Allowance. The Orphans' Court Division requires a Petition, a proposed Order, exhibits to support the petition (by way of example tuition bills, current statement from financial institution), a verification, and a (current) filing fee of $35.00. Reference to the Philadelphia Estate Practitioner Handbook (PEPH), either in hard copy or online, is always helpful.

ETHICS COLUMN

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

How may trust and estate lawyers properly observe their ethical duties of confidentiality when using electronic communications in this rapidly changing era of technology?

Technology is a rather vexing issue for most trust and estate lawyers. It is evolving rapidly, the risks of inadvertent disclosures seem to be increasing, we lawyers often do not have the time, aptitude or inclination to stay abreast of developments and even the experts disagree on the precautions and viability of precautions that we should take.

The Pennsylvania Rules of Professional Conduct do refer to the obligation to embrace and make proper use of technology. Rule 1.1 requires us to provide competent representation and Rule 1.6 prohibits our revealing any "information relating to the representation of the client unless the client gives informed consent." Fortunately, however, and perhaps inevitably, the guidance is quite general and even implies that the extent of the steps and precautions we lawyers take depends on many factors, such as the nature of our practice, the size and resources of our respective firms and the geographical areas in which we practice. Rule 1.6(d) simply says that "A lawyer shall make reasonable efforts to prevent the inadvertent or unauthorized disclosure of, or unauthorized access to, information relating to the representation of a client". Comments 25 and 26 to that Rule permit the lawyer to consider such factors as the sensitivity of the information and the cost and difficulty of employing safeguards. Of course, the client may require certain safeguards or give informed consent to the lawyer's use of certain safeguards.

The American Bar Association first addressed this topic in 1999. ABA Opinion 99-413 states that a lawyer may use unencrypted email without violating the model rules because it "affords a reasonable expectation of privacy from a technological and legal standpoint".

But that was 15 years ago. Today, we are told by experts that the use of services such as AOL, Gmail or Hotmail is not much safer than using postcards. That's because their terms of service, that few of us read but all agree to, effectively permit the services to make use of our emails as they see fit. We and our firms should use a private email account or web domain for all client-related communications. It's certainly more professional and provides greater levels of control over our emails. We now learn that the technologically adept lawyers can detect the data behind the data embedded in our emails. They call that "metadata mining". To prevent such snooping, we should use "scrubbers" when transmitting emails. A further step, of course, is using encrypted email, password-protected documents and even a secure password-protected location for documents.

Those of us using smartphones should employ password protection for such devices and be aware of the issues that arise from mixing personal and professional use.

A growing number of lawyers and firms are also making use of electronic storage services commonly called "clouds". However, some believe that the "cloud" is potentially less secure than paper storage in a warehouse and that we should exercise precautions when selecting the "cloud" service we use, if we use one at all. Obviously, too, no matter what we use to store our files, we must be certain that all reasonable precautions are taken to prevent their loss or destruction. PBA Opinion 2011-200, also quite general, alerts lawyers to the obligation to remain mindful of the risks of using "cloud" services and the need to take reasonable precautions.

One way of determining whether our efforts to prevent improper disclosure are "reasonable" is to stay abreast of our peers in our community engaged in the same kind of practice. Obviously, the small firm in a rural setting should not be expected to use the same technology and precautions as would a Wall Street law firm with

continued on page 23

CASE SUMMARY FROM THE ORPHANS' COURT LITIGATION COMMITTEE

Edward Winslow Taylor, Intervivos Trust, O.C. 3563IV of 1939 (O.C. Phila., August 18, 2014)

BY BRADLEY D. TEREBELO, ESQUIRE | HECKSCHER, TEILLON, TERRILL & SAGER, P.C.
ADAM T. GUSDORFF, ESQUIRE | HECKSCHER, TEILLON, TERRILL & SAGER, P.C.

Section 7740.1(b) of the Probate, Estates and Fiduciaries Code (20 Pa. C.S. §7740.1(b)) provides that a "noncharitable irrevocable trust may be modified upon the consent of all the beneficiaries only if the court concludes that the modification is not inconsistent with a material purpose of the trust." If not all beneficiaries consent to a modification, the modification "may be approved by the court only if the court is satisfied that: (1) if all the beneficiaries had consented, the trust could have been modified or terminated under this section; and (2) the interests of a beneficiary who does not consent will be adequately protected." In *Edward Winslow Taylor,* O.C. 3563 IV of 1939 (O.C. Phila., August 18, 2014) the Philadelphia Orphans' Court addressed whether 20 Pa. C.S. §7740.1 could be used to modify a noncharitable irrevocable trust to add a provision permitting the corporate trustee to be removed and replaced. The Court concluded that it could not modify a trust pursuant to 20 Pa. C.S. §7740.1 to add a trustee removal provision and that the appropriate method to effectuate the removal of the corporate trustee is through the removal statute, 20 Pa. C.S. §7766.

In *Taylor*, the settlor created an irrevocable trust in 1928 and died approximately 10 years thereafter. The trust did not included an explicit provision permitting a trustee to be removed, although it did contain a provision for the appointment of a successor trustee that has been removed, explicitly stating that the successor trustee must be a "recognized banking institution in the City of Philadelphia, Pennsylvania." *Taylor* at 3.

Three of the four income beneficiaries filed a petition with the Clerk of the Philadelphia Orphans' Court requesting that the trust be modified to permit, inter alia, the sui juris income beneficiaries to remove and replace the corporate trustee. It is not clear whether the fourth beneficiary took a position with respect to the petition. The corporate trustee opposed the

continued on page 24

ETHICS COLUMN, CONTINUED

an international clientele including the financial services industry. The larger firms in that arena may well be required to adopt the same kind of rules the Federal Trade Commission imposes or even the stiffer guidelines recommended to financial institutions.

One final word on email communications: We now have a duty to warn our clients about the risks of communicating by email. ABA Opinion 11-459 requires that we warn our clients to "… avoid using a workplace device or system for sensitive or substantive communications, and perhaps for any attorney-client communications, because even seemingly ministerial communications involving matters such as scheduling can have substantive ramifications."

WHAT WOULD YOU LIKE TO SEE IN FUTURE ETHICS COLUMNS?

Send your questions and ideas to:

Paul C. Heintz, Esquire
Obermayer, Rebmann, Maxwell & Hippel LLP
1617 JFK Boulevard
One Penn Center
19th Floor
Philadelphia, PA 19103

TAYLOR, CONTINUED

modification, arguing that "the petitioners improperly rely on Section 7740.1 (d) of the PEF code to modify the trust agreement when the exclusive provision for removing trustees under the PEF code is 20 Pa.C.S. § 7766." *Id*. at 4.

Section 7766 of the PEF Code (20 Pa. C.S. §7766) provides as follows with respect to the court's ability to remove a corporate trustee:

(b) When court may remove trustee.--The court may remove a trustee if it finds that removal of the trustee best serves the interests of the beneficiaries of the trust and is not inconsistent with a material purpose of the trust, a suitable cotrustee or successor trustee is available and:

(1) the trustee has committed a serious breach of trust;

(2) lack of cooperation among cotrustees substantially impairs the administration of the trust;

(3) the trustee has not effectively administered the trust because of the trustee's unfitness, unwillingness or persistent failures; or

(4) there has been a substantial change of circumstances. A corporate reorganization of an institutional trustee, including a plan of merger or consolidation, is not itself a substantial change of circumstances.

20 Pa. C.S. §7766(b).

The beneficiaries argued that modification to add a remove and replace provision was appropriate under 20 Pa. C.S. §7740.1 because the proposed modification was not inconsistent with a material purpose of the trust and because the interests of beneficiaries who did not consent were adequately protected. The Court disagreed. As an initial matter, the Court stated that the beneficiaries did not explain how the interest of beneficiaries who did not consent would be adequately protected.

The Court next considered whether it could have modified the trust had all beneficiaries consented. The Court looked to 20 Pa. C.S. §7766, and it concluded that §7766, and not §7740.1, governed trustee removal. Although the beneficiaries argued that 20 Pa. C.S. §7740.1 was unambiguous and would permit a trust to be modified to add a remove and replace provision, the Court found that "the interrelationship between sections 7740.1 and 7766 create [sic] a clear ambiguity within the Pennsylvania Uniform Trust Act which spans both of these sections." *Taylor* at 10. The Court determined that 20 Pa. C.S. §7740.1 was a "general" statutory provision, through which modification could accomplish various types of actions, whereas 20 Pa. C.S. §7766 was a "specific" statutory provision that addressed trustee removal. *Id*. In such instances, "the special provisions shall prevail and shall be construed as an exception to the general provision[.]" *Id*. (quoting 1 Pa. C.S. §1933).

The Court stated that it "clearly was not the manifest intention of the Pennsylvania legislature to allow beneficiaries to remove a trustee based on [the beneficiaries'] agreement and without satisfying the requirements of section 7766 where the settlor made no provision for trustee removal. The beneficiaries' attempt to use the broad modification provisions in section 7740.1 to eviscerate section 7766 must therefore yield to the specific removal provisions of section 7766." *Taylor* at 10. Accordingly, the Court denied the beneficiaries' petition, but held that it was without prejudice for the beneficiaries to file a petition to remove the corporate trustee under 20 Pa. C.S. §7766, such as for the reasons set forth in *In re: McKinney*, 67 A.3d 824 (Pa. Super. 2013).

NOTE: As of September 17, 2014, the petitioners filed an appeal of the decision of the Orphans' Court to the Superior Court.

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

October Luncheon Program
Tuesday, October 21, 2014
11:45 a.m. - 1:45 p.m.
The Union League
140 S. Broad Street, Philadelphia, PA
Topic: "Some Things You Should Know if There is Something or Someone Foreign in Your Estate Plan"
Speaker: Ellen Harrison

Career Development Event
Wednesday, November 5, 2014
5:30 p.m. – 8:00 p.m.
The Union League
140 S. Broad Street, Philadelphia, PA
Topic: "Managing End of Life Issues"
Speakers: Karl M. Ahlswede, Dana Breslin and David Casarett

November Luncheon Program
Tuesday, November 18, 2014
11:45 a.m. - 1:45 p.m.
The Union League
140 S. Broad Street, Philadelphia, PA
Topic: "Economic Matters"
Speaker: Anirban Basu

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