PHILADELPHIA BAR ASSOCIATION

Probate and Trust Law Section Newsletter

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Report of the Chair

By MARY JANE BARRETT
HARKINS AND HARKINS

In a year in which the Section has many proud accomplishments to its credit, the hands down capstone was the hugely successful Annual Meeting and CLE, superbly planned and executed by Vice Chair Kevin Gilboy on November 28, 2006. Approximately 190 people attended the program entitled "The Uniform Trust Act - Converting the Act into Action." Working with hypotheticals drawn from typical client scenarios, the panel, consisting of Tom Work, Judge Calvin Drayer, Jr., Karen A. Fahrner and Larry Barth, guided the discussion through the intricate web of newly-effective statutory sections, sometimes clearly identifying the solution and other times acknowledging the ambiguity of the outcome. While the challenge of applying this legislation to our client's situations will likely be a topic of continuing discussion for months if not years to come, the panel advanced our comprehension exponentially.

Following the CLE but before adjourning to a fabulous cocktail spread in The Atrium, courtesy of sponsors The Pitcairn Trust Company, Intervention Associates and Sotheby's, the Section's business meeting was held. We took the opportunity to recognize the importance of pro bono service in our area of practice in several forms. First, we acknowledged that on November 15, 2006, the Orphans' Court Pro Bono Publico award had been presented by Administrative Judge Joseph O'Keefe to Probate Section member Anne S. Maxwell. Anne has practiced for many years in the area of guardianships of incapacitated persons, until recently as a sole practitio-

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ner, taking all roles -- as counsel for the petitioner seeking guardianship, as court-appointed counsel for the alleged incapacitated person, and also as guardian when there is a need that cannot otherwise be met. Anne makes our Section and our profession look good, and we were proud to recognize her service.

In addition, we recognized the work of the Philadelphia Volunteer Lawyers for the Indigent Tangled Title Program. This program has relied heavily on Probate Section attorneys, who have responded generously with their time to assist in unadministered estates owning houses, which thereafter become rundown and ineligible for sale or mortgage due to the lack of clear title. The Tangled Title Fund provides funds for the out-of-pocket costs associated with the legal proceedings, such as probate costs, inheritance tax, and title search fees, so that the contribution of the attorney is limited to time and effort. In recognition of the direct service provided by the Tangled Title Program to those needy clients who have limited access to the legal system, as well as the program's positive impact on the stabilization of neighborhoods in the City, the Executive Committee of the Probate and Trust Section awarded the sum of $5,000 to Philadelphia VIP to defray the costs incurred by the Tangled Title Program and complement the work of our volunteer attorneys. This one-time contribution was accepted gratefully by Miriam Jacobson and Marty Costello on behalf of VIP.

Finally, those who render service to the Bar through Committees and other Section activities also merit genuine appreciation and recognition. The work of the Committees is prodigious and the Committee Reports in the Annual Meeting Program are commended to all. The Annual Meeting also provided the occasion for the traditional changing of the guard, whereby we thanked the outgoing Executive Committee members -- David Schwartz, Rebecca Smolen, Tom Hiscott, Bob Louis and Nina Stryker -- for their service, and also welcomed new Executive Committee members -- Terry Kline, Brad Rainer, Laura Stegossi and Mary Kenney. Also congratulated were the newly elected officers -- Margie Thompson as Vice Chair and Rob Friedman as Secretary. In accordance with the by-laws, Kevin Gilboy will become Chair-Elect and Kathleen Stephenson will become the new Chair of the Section.

In parting, I sincerely thank the Section members for the honor and privilege of serving as your Chair for 2006. My four year stint as an officer would not have been as productive or as gratifying without the tremendous fellowship and teamwork of the officers who preceded me as Chair -- Howard Verbofsky, Marilyn Sanborne and Julia Fisher -- and my current fellow officers -- Kathleen, Kevin and Margie. As a team comprised of lawyers from large firms, small firms and financial institutions, we find we can draw on just the right fount of wisdom, memory, judgment, and wit to deal with whatever situation is at hand. As the baton is passed to the indomitable Kathleen Stephenson, I can assure Section members that great things are on the horizon and that next year will be one of the best ever!

NEWSLETTER ARTICLES

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

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The Importance of Reviewing Life Insurance Policies

By KATHRYN H. CRARY AND RYAN R. GAGER, SAUL EWING LLP
RICHARD F. BIBOROSCH, BRANDYWINE FINANCIAL

As life insurance planning continues to evolve, policy owners and counsel must be attentive to the changing landscape. Life insurance policies, like stocks, bonds, and mutual funds, are financial investments, and like any other financial investment, an investment in a life insurance policy should be reviewed periodically to ensure that policy owners are deriving the maximum benefit from the policy.

When and Why Should a Life Insurance Policy be Reviewed?

Although regular periodic policy review is the best practice, certain triggering events should serve as a reminder to review a life insurance policy. One such trigger occurs when life insurance companies merge or are acquired. The surviving entity may offer new, competitive policies with favorable interest rates and mortality charges, without offering these benefits to their in force contracts. Policy review can inform owners on whether or not better options are now available as a result of the merger or acquisition.

Changing interest rates and market returns can also lead to drastic changes in the performance of a life insurance policy. For example, universal life insurance policies sold in the 1980s routinely made double digit interest rate assumptions. Similarly, variable life insurance policies from that time based premium forecasts on double digit returns. In today's interest rate landscape, it requires a dramatic increase in premium payments to meet these initial policy aims. A policy review will reveal whether or not the policy is meeting its performance objectives.

In addition, life insurance policies are priced based on mortality assumptions. As mortality tables become more sophisticated, policies based on old mortality tables may be poorly priced. Similarly, older polices may have given a less favorable rating to the insured because he or she had a condition like high blood pressure or high cholesterol. Today, these conditions are often overlooked for pricing purposes and the policies can be priced at standard rates if the conditions are treated with medication that keeps them in normal range.

Certain life events should also trigger policy review. The death of a beneficiary, a policy owner's divorce or a falling out with named beneficiaries could lead to a change in beneficiary designation and perhaps a change in the type or amount of life insurance owned. Businesses that own life insurance on key employees should similarly review policies when a business is sold or there is a fundamental change in the structure of the business.

Owners' Options After the Policy has been Reviewed

After policy review, it may be necessary to take certain actions. First, and most obviously, beneficiary designations may need to be changed. Second, if a policy is underperforming, the policy owner can choose to pay higher premiums to ensure that the policy performs up to the required level. In other cases, policy owners can benefit from surrendering their current policies, potentially in favor of more competitive options. Finally, a policy owner can sell his or her policy to a life settlement company. Such sales are generally referred to as viatical or life settlement transactions, and they present increasingly utilized, and scrutinized, planning opportunities.

A life settlement is generally defined as the sale of a life insurance policy by the owner for a purchase price that exceeds the policy's cash surrender value. Under certain conditions, entering into life settlements can allow policy owners to receive significant payments for their term insurance policies or, in some cases, payments in excess of three or four times a whole life policy's cash value. Life settlement companies and individual investors enter into these transactions because they are willing to risk that the insured will die before the amount the buyer paid exceeds the death benefit. Although the benefits for both buyers and sellers can be high, life settlements occur largely in an unregulated environment. This puts the burden on sellers, investors, and their counsel, to do their homework when working with a broker or acting on their own to buy and sell life insurance policies.

The relative lack of regulations in the life settlement environment has led to allegations of deception and fraud. Most recently, New York State Attorney General Eliot Spitzer filed a complaint in

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Life Insurance Policies, continued

against life settlement company Coventry First, an industry leader. Spitzer's suit alleges that Coventry First engaged in deceptive practices that defrauded individual sellers of life insurance policies. Specifically, Spitzer contends, the company colluded with life settlement brokers to suppress information about bids for the owners' policies from other life settlement companies. In addition, Spitzer charges Coventry First representatives with inducing brokers to do business with them by presenting "gross offers" that allowed brokers to pick and choose what percentage of the offer would go to the seller of the policy and what percentage would go towards the broker's commission.[1]

In an attempt to introduce some regulation into the industry, the National Association of Insurance Commissioners promulgated the Viatical Settlements Model Act in the mid-1990s. Pennsylvania subsequently enacted its own Viatical Settlements Act ("VSA").[2] The Pennsylvania VSA provides guidelines that require viatical settlement providers and brokers to be licensed in Pennsylvania. The Pennsylvania VSA also includes disclosure requirements, under which policy owners must receive information about possible alternatives to viatical settlement contracts and the possible taxation and estate planning consequences of viatical settlements. However, Pennsylvania's VSA does not require viatical settlement brokers to provide policy owners with a list of all the offers or counter-offers made by various life settlement companies for an individual policy. In addition, brokers are not required to disclose any affiliations or other arrangements between the broker and any proposed buyer of the policy.

There is movement to amend the Viatical Settlements Model Act to address the concerns raised by the potential for fraud involved in life settlement transactions. It appears that the amended Model Act will include increased disclosure and licensing requirements and could also further enhance protection for policy owners through the addition of stiffer penalties for violators of the disclosure rules. Pennsylvania and other states would then have to act to amend their VSAs to address these issues. In the meantime, it is imperative that policy owners and their advisors engage in scrupulous due diligence before entering into a life settlement.

Conclusion

From changing interest rates to the rapid growth of the life settlement industry, there are a myriad of reasons for life insurance owners and their advisors to periodically review their policies. Failure to do so risks the loss of significant planning opportunities, and may keep policy owners from deriving the greatest possible benefit from their policies.

[1] For an in-depth analysis of the Coventry First charges, see Stephen Leimberg's October 30, 2006 online newsletter entitled "Life Settlements Become Famous in Infamous Way,"

[2] Pennsylvania's VSA, which became effective in 2003, is codified at 40 Pa. Cons. Stat. §§ 626.1-626.17.

JOIN A COMMITTEE

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

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Sen. Stewart J. Greenleaf Summarizes Senate Bill 628 for Colleagues

October 13, 2006

TO: ALL SENATORS

FROM: Stewart J. Greenleaf

SUBJECT: Senate Bill 628 (Advance Directives)

Senate Bill 628, Printer's No. 2117, is before the Senate for a final vote and because it is a complex bill with a long history, I am taking this opportunity to share with you this background and summary. Senate Bill 628 amends the Probate, Estates and Fiduciaries Code, Title 20 of the Pennsylvania Consolidated Statutes, adding Chapter 54 to further provide a statutory means for competent adults to control their health care either directly through instructions written in advance (living wills) or indirectly through a health care agent (health care powers of attorney) or health care representative when there is no advance directive. A conforming amendment is made to the Crimes Code, Title 18 of the Pennsylvania Consolidated Statutes.

The legislation had its roots in the Joint State Government Commission Advisory Committee on Decedents' Estates Laws ' report entitled "A Health Care Decision-Making Proposal, A Prudent Investor Rule and Other Proposed Amendments" (March 1998), and updated in the commission's staff report entitled "Proposed Health Care Decision-Making Provisions under Chapter 54 of Title 20 of the Pennsylvania Consolidated Statutes" (February 2002). In addition to the advisory committee's recommendations, the legislation as introduced during past sessions was the result of numerous meetings with individuals representing the legal and medical professions, the religious community, and state government agencies.

During the 2003-2004 session, I introduced this legislation as Senate Bill 492. The Senate and the House of Representatives both unanimously passed Senate Bill 492 only to have the Governor veto the legislation largely because of objections raised by the medical community. Following the Governor's veto of Senate Bill 492, the Governor's office proposed amendments to resolve their concerns. A working group was established to discuss those recommendations. In addition to legislative staff, the working group was comprised of individuals representing the Governor's Office, the medical community, the legal profession, the disability community, and the Pennsylvania Catholic Conference.

Senate Bill 628, Printer's No. 2117, reflects a consensus based on many hours of meetings, telephone conference calls, drafts and re-drafts. The Joint State Government Commission staff organized the meetings and calls, and put the various ideas into legislative form. The result of this work is a better bill. With the enactment of Senate Bill 628, Pennsylvania's law will not only give people more information and tools to make decisions in advance about their health care but will also do a better job of protecting the disabled.

The Joint State Government Commission staff provided the following summary of Senate Bill 628's key provisions:

SENATE BILL 628 SUMMARY

1. Replaces Chapters 54 and 54A with a revised and restructured Chapter 54 to include living wills (Subchapter B), health care agents and representatives (Subchapter C) and out-of hospital nonresuscitation (Subchapter E).

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Memo from Sen. Greenleaf, continued

2. Provides a comprehensive statutory framework for health care powers of attorney (Subchapter C) and creates an optional form (Subchapter D).

    A. Permits a principal to allow a health care agent to make all health care decisions for the principal, including those concerning life-sustaining treatment (Section 5456).

    B. Permits a principal to appoint multiple and successor health care agents (Section 5455).

    C. Provides that a principal may countermand a health care decision made by the principal's health care agent (Section 5457).

    D. Explains how a health care power of attorney may be amended (Section 5458).

    E. Explains how to revoke a health care power of attorney and the effect of a revocation (Section 5459).

3. Uses the more common term, "living will," instead of the current statutory term, "declaration" (Section 5422) but forms with "declaration" remain valid (Section 7 of bill).

4. Provides a model living will and health care power of attorney form based on the form promulgated about 12 years ago by the Allegheny County Bar Association and the Allegheny Medical Society (Section 5471).

5. Replaces the term "terminal condition" with the term "end stage medical condition" while keeping the substance of the definition the same and clarifying the definition of "end-stage medical condition" to ensure that an individual's wishes are followed and that the individual receives medical care if the individual would benefit from the treatment and it would not merely prolong the process of dying (Section 5422).

6. Prohibits a Commonwealth agency that licenses health care providers or regulates health care (most likely the Department of Health) from prescribing a mandatory form (Section 5433).

7. Allows an emancipated minor to execute a living will and a health care power of attorney, have a health care representative, and secure an out-of-hospital do-not-resuscitate order (Sections 5442(a)(4), 5452(a)(4), 5461(a)(1) and 5484).

8. Adds provisions authorizing health care representatives to make health care decisions when there is no health care agent (Section 5461).

9. Sets forth a statutory default to determine who may act as a health care representative in descending order of priority (Section 5461(d)).

10. Allows a principal to designate a health care representative (Section 5461(d)(1)).

11. Allows a principal to disqualify a health care representative (Section 5461(e)).

12. Provides that upon the petition of any member of a class of potential health care representatives, the court may disqualify for cause shown an individual otherwise eligible to serve (Section 5461(e)).

13. Gives the adult children of the principal who are not the children of the spouse the same priority to act as health

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care representatives as the spouse (Section 5461(d)(1)(i)).

14. With regard to a care-dependent person, allows a health care representative to only make decisions regarding treatment, care, goods or services that a caretaker is obligated to provide to that care-dependent person who has an end-stage medical condition or is permanently unconscious (Section 5461(b)).

15. Adds an affirmative defense to charges filed under 18 Pa.C.S. §2713 (neglect of care-dependent person) for a caretaker's, individual's or facility's lawful compliance with the direction of the care dependent person's health care representative as provided in Section 5461(b) (18 Pa.C.S. §2713(e)(5)).

16. Provides statutory guidance for health care decisions by a health care agent and a health care representative and assigns the Department of Health oversight responsibilities (Section 5456(c)).

17. In the absence of a written direction to the contrary, creates a presumption that the principal would not want nutrition and hydration withheld or withdrawn and provides how that presumption is overcome (Section 5456(c)).

18. In establishing whether the presumption has been overcome, distinguishes between clearly expressed wishes of the principal regarding nutrition and hydration and the absence of such clearly expressed wishes (Section 5456 (c)).

19. Permits a person who is permanently unconscious to secure an out-of-hospital-do-not-resuscitate order without requiring that person to have an operative living will (Section 5483).

20. Provides that a health care provider shall not be subject to criminal or civil liability, discipline for unprofessional conduct or administrative sanctions for refusing to comply with a direction or decision of an individual based on a good faith belief that compliance would be unethical or, to a reasonable degree of medical certainty, would result in a medical care having no medical basis in addressing any medical need or condition of the patient (Section 5431(a)).

21. Expressly provides that the chapter doesn't require a health care provider to maintain copies of medical records beyond the requirements otherwise imposed by applicable law and regulation (Section 5434).

22. Requires the Department of Health to establish a committee to assist it in determining the advisability of using a standardized form containing orders by physicians that detail the scope of medical treatment for patients' life sustaining wishes (Section 5488).

Probate Lawyers As Involuntary Curators of Art and Antiques Collections – Is this a Job You Want?

By MICHAEL MENDELSOHN

Probate lawyers become the involuntary curator of art and antique collections more commonly than even they will probably acknowledge. This is because they may be in denial that a problem exists. My purpose is to share with you why art and antiques assets require more consideration than they are generally given both in estate planning and post mortem fact patterns. I will also illustrate that if proper lifetime time planning is undertaken, the uncomfortable role of involuntary curator in the post mortem fact pattern can completely disappear.

A file shows up on your desk that looks neat and clean—a $6 million estate with most of the assets in an insurance policy, a single-family residence, and the proceeds of a 401(k). Then an inventory arrives. It turns out the decedent's husband was an art history professor who acquired beautiful things throughout his long collecting career. The inventory discloses collections of South American artifacts, advertising posters, a 1957 Karmann Ghia coupe, and a lot of French wine in the basement. The house is furnished in the French Modern style with original pieces by Ruhlmann, Breuer, Herbst, and Jourdain. The items have never been appraised, insured, authenticated, and validated for proper title, and have always been in the home of the professor and his wife. After the professor's death his wife continued to live in the jointly-owned residence with all of the furnishings in place. The professor's estate was a very simple probate because of prior planning. A federal estate tax return was filed two years ago, which did not disclose any art or antiques assets.

You, as the probate attorney have just become the involuntary curator of a very significant group of collections. You may not be that knowledgeable about art or antiques but conventional wisdom dictates that you will call an auction house and get an estimate of the value of these items. The auction house reports that the South American artifacts are very early and quite valuable, the car is highly collectible, the wine collection is superb, and the furniture and posters are a gold mine. Now what?

It has been shown that an unplanned auction sale of the art and antiques assets may cost the beneficiaries up to 70 percent of the value of the collection. By the time estate taxes, seller's premiums, transaction costs, under-valued sales, and unsold items are factored in, the collection could be liquidated for a fraction of the estimated value. My prediction is that it is just a matter of time before an attorney is called on the carpet by an angry heir, who is willing to sue based on the financial loss of the collection's value. Lifetime planning for these assets can avoid the involuntary curator dilemma. But if that has not transpired, the attorney may want to think seriously about post-mortem options involving an experienced art succession planner who can assist with the determination of alternative liquidation strategies that will preserve much of the value of the collection.

So what is the best way to liquidate the assets so that the heirs are certain to have enough resources to pay the taxes due? Here is an overview of the issues:

- Is an auction sale the best way to dispose of the items in the collection? Would it be better to identify dealers with an excellent network of potential buyers?
- Is the local auction house the best venue for the sale or would a metropolitan area be more appropriate?
- Does it make sense to sell everything in one auction sale, or could we realize more by consigning items to specialty auctions that attract collectors who focus in particular areas of collecting?
- How do we get a professional opinion of value to help in the negotiations with the auction house and setting pre-sale estimates and reserves?
- Should the finest items be authenticated and/or conserved and restored in order to support higher valuation and appraisal estimates?

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Assessing the Needs of Your Older Client

By SHARI VANDERGAST, LCSW, JD

Intervention Associates is a not-for-profit Quaker care management and home care agency founded over 20 years ago by Marsha Solmssen and Marion Thompson. One of the areas of our expertise is in evaluating the care needed and safety of older adults who are living alone. The following article is reprinted with permission from the National Academy of Elderlaw Attornies, and may be helpful to you as you evaluate your interactions with your older clients.

Working with older clients can be both very rewarding and challenging. At times you may be concerned about the physical or mental health and well-being of your older client. In this article we will review some of the common questions and concerns that may arise in your work with your older client, and suggest steps that you or the client's family may take to ensure that she/he is getting the care and services that are needed.

When assessing the needs of your older client, you will want to ask the following questions:

- Do I know when my client has last seen a doctor? A dentist?
- Do I know what her diagnoses are?
- Is my client a candidate for geriatric assessment?

In determining whether fur-ther medical assessment is needed you may want to consider the following:

- Does your client appear unclean or inappropriately dressed?
- Does your client remember past interactions with you?
- Is your client repetitive or perseverative?

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Lawyers as Curators, continued

- Does the estate have good title to the pieces – are there any gaps in the chain of title or might the South American artifacts have been illegally removed from these countries?
- Is borrowing against some of the items in the collection to pay the taxes enabling the estate to retain some of the pieces as an investment a viable strategy?
- And finally, what is to be done with the troublesome problem of items that did not sell at the auction?

While admittedly these questions are daunting, their solutions are manageable. In my new book *Life is Short, Art is Long – Maximizing Estate Planning Strategies for Collectors of Art, Antiques, and Collectibles (2006,Wealth Management Press)*, I have mapped out strategies and tactics that will enable you to maximize the value of an art and antique collection just as you manage the other assets in the estate. The book is the result of twenty years researching; talking to experts in the fields of law, tax planning, estate planning, financial planning, and art; and working with dealers, museum curators, and auction houses in order to come up with effective planning approaches for people who collect.

The strategies we have come up with will create significant tax savings and optimize the value of intergenerational wealth transfer using the legal and financial vehicles you work with in your practice everyday – you are just not accustomed to using them to plan for art assets. The book demonstrates the importance of piece-by-piece analysis of the items that comprise the collection, how you can layer gifting and wealth replacement techniques to get more bang from your "bucket" and why conventional approaches to liquidation can reduce the value of a collection by up to 70% of its value. Perhaps most importantly however, this book will show you how you can significantly increase your value to your clients whose estate's assets consist of art, antiques, and other valuable stuff by implementing art succession planning strategies and why you may have an ethical obligation to raise your level of scrutiny in suggesting planning options for these unique assets.

Michael Mendelsohn is president of Briddge Art Strategies Ltd. www.briddgeartstrategies.com, an art succession planning firm in Purchase, New York. His book *Life is Short, Art is Long—Maximizing Estate Planning Strategies for Collectors of Art, Antiques and Collectibles* will publish in January, 2007. Visit his website to learn more about art succession strategies and to sign up for his free newsletter.

Assessing Your Older Client,continued

- Have family members or friends expressed concern?

- Does your client seem unduly influenced by family or friends?

- Has your client expressed feelings of hopelessness/ helplessness or does she seem depressed, anxious, forgetful or even delusional?

- Has there been involvement from the police or older adult protective services?

A geriatric assessment is a comprehensive, interdisciplinary assessment of a client's medical, functional, social and emotional status which results in a written report with recommendations for both current and future support and care needs. Components of a geriatric assessment may include:

- Internal medicine/geriatric

- Physician evaluation Laboratory or other diagnostic tests

- Mini-mental status evaluation

- Neurological evaluation

- Psychiatric evaluation

- Nursing or functional status evaluation; and

- Occupational, speech and/or physical therapy evaluations.

Geriatric assessment centers can be found at many major university medical centers. Most assessments are covered by Medicare or other medical insurance plans.

Do you suspect that your client is suffering from memory loss? Memory loss may be a result of a number of medical and neurological problems, including cardiac, pulmonary, and metabolic problems. Always recommend that your client receive a complete medical work-up when memory loss is present. Short-term memory loss is more indicative of conditions such as Alzheimer's Disease and multi-infarct dementia. Sudden loss of memory may be a symptom of more sudden and severe problems such as stroke or medically-induced delirium. Does your client have a long history of alcohol use/abuse? Korsakov's Syndrome is an alcohol-induced dementia that his physician should consider.

Once you have determined that your client has a memory impairment, it is important to assess her level of functioning. Some important questions to ask are:

- Can my client perform activities of daily living (ADLs) such as bathing, dressing, walking, or personal care?

- Can my client complete instrumental activities of daily living (IADLs) such as shopping, meal preparation, basic cleaning of her residence, paying bills, or making telephone calls?

In the moderate or later stages of memory loss or dementia, an assessment of the individual's ability to live safely is crucial. Many clients will need additional supportive services to enable them to continue to live at home, or may need to consider a residential placement of some kind. In determining whether a client is living at home safely, you will want to consider whether your client has:

- Wandered away from her residence, even one time

- Failed to keep doctors' appointments

- Forgotten prior discussions with you or agreements that she has made or signed

- Left the water or stove on in her home

- Gotten lost while driving or taking public transportation

- Fallen without the ability to get up

- Experienced a significant medical problem but refused to accept treatment

- Had substantial problems with household management; or

- Called police or other authorities to report problems that are later unsubstantiated.

At some point, it may be necessary for your client to stop driving. This is often a difficult and painful decision for both the client and his/her adult children. In the best of circumstances, family members identify the problem and speak with their older relative, who agrees to cease diving. At times, the older adult disagrees with this assessment, and a professional may need to become involved. In this circumstance an evaluation with the client's physician should be arranged.

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2006 Committee Reports

Closely Held Business Committee

By KARIN M. KINNEY, CHAIR

The Closely Held Business Committee was formed in 2005 to explore issues unique to the closely held business and to serve as a resource for attorneys representing the private business owner. The Committee places particular focus on clients with active operating businesses, such as multi-generational family companies.

The Committee advocates the use of a long range, proactive and multidisciplinary approach to counseling the small business owner. Some of the topics addressed by the Committee are buy-sell arrangements, life and death transfers, income and estate tax issues, valuations, and management succession issues.

Meetings are scheduled periodically (usually every other month) and involve either a discussion of issues of interest to committee members or a guest speaker presentation. In 2006, guest speaker topics included business valuation procedures, new IRS rules affecting deferred compensation arrangements, and advice to the business owner when selling the family business.

Initiatives in 2007 will include efforts to increase awareness of the importance of incorporating other disciplines (e.g. corporate law, accounting, strategic planning, and income tax strategies) in the overall counseling approach to the small business owner. As part of these efforts, the Committee expects to host a seminar entitled "A Family of Laws for the Family Lawyer," at which practitioners from several legal disciplines will provide an overview of how the various types of laws affect the closely held operating business. In 2007, the Committee will also continue to host meetings for discussion purposes and to invite guest speakers to address specific areas of interest.

Any Probate Section member wishing to join the Closely Held Business Committee or having ideas for discussion topics should contact Karin M. Kinney at McCarter English LLP, 215-979-3846, or kkinney@mccarter.com.

Assessing Your Older Client, continued

Once a physician evaluates the older adult, a referral to a driving evaluation center may be made. Such centers are affiliated with rehabilitation hospitals, and can be helpful if evaluating drivers for visual, hearing or neurological impairments that may affect diving ability, as well as provide functional assessments of clients' motor skills and response times. All of these factors will determine whether an individual can continue to drive safely. If needed, physicians and driving evaluation centers may begin the process of notifying the state Department of Motor Vehicles that a client's driving privileges must be revoked.

Your older client may present challenges that take you outside your usual scope of practice. For that reason, it may be helpful for you to form relationships with quality physicians, psychiatrists, care managers and home care agencies whom you trust to provide service to your clients. This will help you to be prepared when the inevitable urgent phone call comes.

As a result of Intervention's increasing aging client population we now provide assistance to clients with tasks such as paying bills and balancing a checkbook. The article's author Shari VanderGast, LCSW, JD and professional staff are always available to support members of the probate bar and to offer advice about client care needs and to provide inservice training, free of charge, to your professional staff. We can be reached at 610-254-9001.

Shari VanderGast, LCSW, JD, is Executive Director of Intervention Associates, a Quaker-affiliated not-for-profit care management and home care agency located serving the Delaware Valley.

Publications Committee

By ROBERT H. LOUIS, CHAIR

The Publications Committee has continued with its mission to produce the newsletter of the Section three times per year. We have been fortunate in obtaining interesting articles both from members of the Section and from non-lawyers who work in industries that touch upon trusts and estates work. Our transformation of the newsletter into an e-mail publication has not only reduced the expenses of the Section, but has resulted in faster distribution of the newsletter.

This year, we began a new feature, the publication of E-alerts that are sent to the entire Section to bring to the members' attention fast-breaking developments in the law and in the administration of trusts and estates. In the future, we will continue to look for ways to get more information to Section members as quickly as possible.

Education Committee

By KAREN MCCANN STOCKMAL, CHAIR

In the past year, the Education Committee worked to provide quality continuing legal education programs of interest to members of our Section. These programs were presented at the first three quarterly meetings of the year. Our programs this year were:

1. March 7: Are Storm Clouds on the Charitable Horizon?

This well received course planned by Committee members Jeffrey Wolken, Paula Jones and Laura Stegossi, focused on the pitfalls and opportunities related to the use of common charitable planning techniques during this period of heightened scrutiny by Congress and the Internal Revenue Service. The speakers were Jaffray L. Edens (Brandywine Conservatory, Inc.), Kathy C. Mandelbaum (Temple University Beasley School of Law), Carol Kroch (Wilmington Trust Company) and Eric Vieland, (Montgomery, McCracken, Walker & Rhoads, LLP). Materials were also contributed by Frederick J. Gerhart (Dechert LLP).

2. June 6: Fiduciary Law in the First State

This program was especially well attended and came out of an interest expressed by the Executive Committee and a number of Section members. It addressed the issues which a Pennsylvania practitioner may encounter relative to Delaware law. The speakers were Steven R. Director (The Bayard Firm), Todd A. Flubacher (Morris, Nichols, Arsht & Tunnell, LLP), Thomas O. Hiscott (Heckscher, Teillon, Terrill & Sager, P.C.) and Anne L. Stallman.

3. October 3: Hedging Your Bet

This program, which received particularly excellent feedback, addressed what a practitioner needs to know about advising fiduciaries on alternative investments. Robert L. Freedman (Dechert LLP) and Robert M. Ballentine (Wilmington Trust Company) provided both a primer on alternative investments and an analysis of their place in the investment selection by a fiduciary.

New members from the Section are always welcome to attend our meetings. We seek to have our committee reflect the diversity of our Section members in terms of practice specialties, client base and firm size. Our meetings are held on the second Tuesday of January, February, March, May, June, September, October and November and members are welcome to participate by teleconference or in person.

Finally, our Committee is undergoing a time of transition. While our mission remains the same, our long-time Chair, Judy Stein, has decided to step down. Judy has been called upon by the Executive Committee to serve in a new capacity as the liaison amongst the Section committees and the Executive Committee. It is easy to see why the Executive Committee has called upon Judy. Her service to our Section in past years has been exemplary. She has led the Education Committee with tremendous drive and has consistently inspired our members. Judy's commitment to our Section is evident to all who know her. She has been a steadfast leader, tireless volunteer and a strong advocate for maintaining the highest standards for our CLE programs. Indeed, our Committee's success over the last year and many years prior is largely attributable to Judy's dedication and skill. Fortunately, Judy has agreed to remain on the Committee so that we will continue to benefit from her expertise.

Taxation Committee

By JILL R. FOWLER, CHAIR

The Taxation Committee once again hosted a number of excellent speakers who spoke on selected topics of interest to members of the Probate and Trust Law Section. The focus was on topics that were timely and that had a practical application to our practices. We were fortunate enough to enlist a number of well-respected volunteers to address our meetings.

Among the speakers this year were Tom Hiscott of Heckscher, Teillon, Terrill & Sager. At our March meeting, Tom made a presentation on the use of conduit trusts in planning with qualified retirement plan benefits, including practical drafting suggestions. At our April meeting, Al Gibbons of AEG Financial Services led a lively discussion featuring Steve Leimberg of Leimberg Services and Nat Shapowill of Coventry First. The discussion focused on the risks and rewards of non-recourse premium financing (also known as "third-party"-owned life insurance).

Roberta Barsotti of PNC Bank made a well-received presentation on planning with charitable remainder trusts which included a discussion of both the estate and income tax aspects of these vehicles. Probate Section Chair, Mary Jane Barrett of Harkins & Harkins, gave a detailed summary of the new Medicaid Rules. She also discussed the practical implications of the new rules with respect to planning for elderly clients.

After a "summer vacation," we were pleased to welcome Angela Titus, of Archer & Greiner, who explained the tax and non-tax implications of the New Jersey Domestic Partnership Act. Our October meeting featured John Murphy and Paul Dibert of the Pennsylvania Department of Revenue, who, along with Jim Millar (Assistant Counsel in the Office of Chief Counsel), provided an interesting discussion of developments in the administration of the inheritance tax laws.

The Committee looks forward to its November meeting when Christopher Camp of Pepper, Hamilton LLP will discuss planning with Grantor Retained Annuity Trusts, and its December meeting with John Darasdi from the Internal Revenue Service.

Special thanks are due to Matthew Rosin, past Chair, and Ballard Spahr Andrews & Ingersoll, for graciously hosting the Committee's meetings for the first half of the year, as well as to Roberta Barsotti, Secretary, and PNC Bank, N.A., which has kindly agreed to host the Committee's meetings going forward. The Committee would also like to thank our Secretary, Roberta Barsotti, for her work on the minutes of the meetings, many of which are circulated on the Section's list serve, allowing all members of the Section to benefit from our speakers' presentations and the Committee's collective knowledge and insights.

Legislative Committee

By ROBERT I. FRIEDMAN, CHAIR

The Legislative Committee had an active year, considering a variety of legislative and regulatory developments.

The Committee reviewed a number of proposed bills relating to the Probate, Estates and Fiduciaries Code, including:

1. An amendment to the power of attorney provisions which would require periodic court filings by an agent.

2. An amendment which would authorize community redevelopment authorities to obtain letters of administration for estates with real property.

3. A comprehensive amendment to the Code regarding advanced directives.

Arising from its review of the proposed amendment to the power of attorney provisions, the Committee discussed other issues regarding this statute and expects to consider and possibly propose a miscellany of amendments to clarify certain provisions. Also as part of this process, the Committee recommended the revival of the Section's efforts to promulgate a uniform banking power of attorney, which, thanks to the efforts of other Section members, has now been successfully launched.

The Committee marshaled its forces this summer to review the amendments which have been pro-

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Rules and Practice Committee

By NINA B. STRYKER, CHAIR

The Rules and Practice Committee continued its work on a variety of projects this year. We continued to provide assistance with the e-filing system both in the Orphans' Court Division and to the Office of the Register of Wills. We worked with Dominic Rossi, Deputy Court Administrator for Legal Services for the First Judicial District to monitor and trouble-shoot issues for Orphans' Court e-filing project, and to serve as a sounding board for the Section. At the June Probate Section luncheon, the Register of Wills, the Honorable Ronald Donatucci, announced the introduction of e-filing in the Register of Wills Office which will be on-line shortly. We thank the ad hoc committee (led by Mary Jane Barrett and Gene Gillin) which advised and assisted the Register of Wills' technical team, including Michael McLaughlin and Lou DiRenzo, in promoting and launching this state of the art e-filing program. Our committee stands ready to consider new rules for adoption that will incorporate new developments in our practice as a result of the e-filing capability.

As part of the on-going state-wide forms project, our committee reviewed and commented on new forms of Model Fiduciary Accounts, including an accounting based on the total return trust model, to be submitted to the Supreme Court Orphans' Court Rules Committee for consideration. We also note the very recent adoption of state-wide forms for use in the Orphans' Court and Register of Wills offices. Our congratulations to Mary Jane Barrett, Chair of the Supreme Court Orphans' Court Procedural Rules Committee who has been instrumental in shepherding the state-wide forms project through the system for formal adoption by the Supreme Court of Pennsylvania.

The Committee also provided comment to the Power of Attorney Banking Form for Banking Transactions drafted by Gene Gillin. This form has been approved by the Section's Executive Committee and will be added to the PEPH (Philadelphia Estate Practitioner Handbook) website and to the hardcopy handbook.

We have recently begun consideration of the Joint General Court Regulation 97-1, the Procedure for Approval of Compromises involving Minors, Incapacitated Persons, Wrongful Death and Survival Actions, and we welcome comment from other members of the Section on this matter.

Our Committee's work would be impossible to accomplish without the hard word of our dedicated committee members, and our secretary, Sue Lomas. My personal thanks to all of the Committee members for their time, thoughtful consideration and dedication to the work of the Section.

New members are always welcome. We meet on the second Tuesday of the month at 4:00 P.M. in the offices of Obermayer Rebmann Maxwell & Hippel LLP, 19th Floor.

Legislative Committee Report, continued

posed to Rule 1.15 of the Pennsylvania Rules of Professional Conduct and Rule 221 of the Pennsylvania Rules of Disciplinary Enforcement. These proposed changes relate to the safekeeping of client property and may be of significant consequence to lawyers who serve as fiduciaries. The Committee served as a forum for a discussion of these issues, leading to submissions by the Section and its members to the Disciplinary Board.

Finally, during the course of the year the Committee continued its consideration of a so-called "decanting" statute, which would authorize a trustee, in certain circumstances, to distribute trust property to a new trust.

Elder Law Committee

By KEELIN S. BARRY, CHAIR

What is Elder Law?

Elder Law is among those few areas of law defined by the population served instead of the subject matter content. Elder Law practitioners develop expertise and contacts to help older clients and their families with legal planning and problems related to aging. Medicaid planning for those needing nursing home care, Advance Healthcare Directives, Estate Planning and Administration, Guardianships, and Public Benefits are among the staples of this area of practice. However, the Elder Law practitioner also must be able to steer clients through

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Elder Law Committee Report, continued

problems relating to deeds, financial scams, and grandparent visitation and custody rights. It truly is an ever-changing area of practice.

Committee-sponsored Programs

During 2006, the Elder Law Committee has offered programs to educate the legal community about the following cutting-edge issues:

January 17, 2006 "Psychosocial Issues in Working with Older Clients" with Shari Vandergast, Attorney, Psychologist, & Director of Interventions Associates, one of oldest care management organizations in our area. Dementia, Safety Issues, and When to Seek a Health Assessment were addressed as non-law topics that Elder Law attorneys are expected to know about.

March 30, 2006 "The Civil Side of Scams, Fraud, and Financial Elder Abuse" with Katherine Weiss, Esquire, Director of the Senior Law Project's Project S.A.F.E. (Stop Abuse and Financial Exploitation)

April 27, 2006 "Are Reverse Mortgages a Good Choice for Seniors?" with Frank Montufar and Steve Vogt, Principals, ACRE Mortgage and Allan White, Community Legal Services

June 29, 2006 "Medicaid Update: Act 42, DRA & other changes" with our panel of experts

October 26, 2006 "Ten Years of Lessons: Moving Distress Syndrome, Hoarding, & Other Things I've learned over the years" with Margit Novack, Founder of Moving Solutions, Inc.

November 30, 2006 "Reviewing the Continuing Care Life Community Contract"with Paul Feldman

Speakers Available for Your Group

If your group is interested in Elder Law topics, we can send an experienced speaker address your group. Call us at the Philadelphia Bar Association.

What will the Elder Law Committee do in 2007?

During 2007, the Elder Law Committee will continue to offer monthly educational programs for attorneys on cutting-edge legal topics and provide community education. Specifically, the Committee will work on a Senior Law Handbook for Philadelphia's seniors and provide speakers to groups as requested.

Public Service Committee

By HOWARD M. SOLOMAN, CHAIR

The Public Service Committee is in the process of reorganizing and new members therefore are welcome. If you are interested, please contact Howard Soloman at 215-568-9474. After adding some new members, the Committee will reexamine its mission and explore new ways to accomplish its mission. In the meantime, the Committee organized a workshop together with the Homeless Advocacy Project at a local housing program for AIDS victims to provide the residents with Wills, Living Wills and Powers of Attorney. Approximately ten residents were served and the Committee hopes to organize similar workshops in the future. The Committee also is preparing a comprehensive handbook to assist practitioners who are handling guardianship cases in Philadelphia. We look forward to an exciting year in 2007.

Orphans' Court Litigation and Dispute Resolution Committee

By LAWRENCE C. NORFORD, CHAIR

The Orphans' Court Litigation and Dispute Resolution Committee was formed in 2005. The Committee's members include a number of leading Orphans' Court practitioners as well as lawyers who are developing an Orphans' Court practice or whose practice sometimes places them in the Orphans' Court in contested matters.

The mission of the Committee is to improve the quality of practice before the Orphans' Court through:

- the exchange of knowledge, ideas, and information, and

- the consideration and possible endorsement of changes to court rules and of new or alternative methods of resolving Orphans' Court disputes.

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ETHICS COLUMN

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

Shortly after you undertake the representation of the proponent in a Will contest, you are approached by one of the contestants who, unaware of your existing representation, asks you to take his case. Obviously, you must decline the representation. However, can you explain your reason for declining? May you refer the contestant to another attorney? May you ask for a referral fee if that attorney is retained?

Our obligation to maintain client confidences is one of the most sacred duties we owe to our client and is embodied in Rule 1.6 of the Rules of Professional Conduct. The duty also applies to information received from prospective clients even though a lawyer-client relationship never develops. The attorney should not reveal to his prospective client the grounds for the declination and certainly not the name of the existing client, even though the prospective client may, ultimately, learn of the representation as the contest unfolds. (Of course, great care must be exercised when dealing with a prospective client in cases like this because the acquisition of too much knowledge of a prospective client's case could form grounds for later disqualification.) Furthermore, because the information received from prospective clients is also subject to those same rules of confidentiality, the attorney may not advise the existing client of the inquiry from the prospective client. See Formal Opinion 1979-1 issued by the Pennsylvania Bar Association's Committee on Professional Responsibility and that Committee's Informal Opinions 90-174 and 97-78.

What about referring the prospective client to another attorney? Here, the attorney encounters a most interesting dilemma. Notwithstanding the lack of formal representation if one decides to refer the prospective client to another attorney, one must, while carrying out the duties owed to that prospective client, provide sound advice based on well exercised professional judgment. If the attorney has an obligation to refer the prospective client to a good lawyer, however, does that constitute a breach of the attorney's duty of undivided loyalty to the existing client? It would seem so. However, at least one Ethics Committee has decided that that may not always be the case. The District of Columbia Bar issued Ethics Opinion 326 in December of 2004 in which it opined that "we believe that it is consistent with the concept of our adversary system, and not prohibited by the Rules of Professional Conduct, for a lawyer, if she chooses, to refer a person seeking representation to another lawyer, even if the representation would be adverse to the referring lawyer's existing client. Each lawyer must decide for herself whether, under the particular circumstances, this is a wise thing to do." In fact, experienced estate practitioners may well believe they would be providing a good service to their client by making certain that the prospective client, their adversary, is represented by a lawyer who has experience in Will contests. In any event, if the attorney chooses to make a referral, the attorney is obligated to (1) determine that such referral would not negatively affect

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Orphans' Court Litigation and Dispute Resolution Comittee Report, continued

The Committee meets on the third Thursday of every other month at 4:00 p.m. at the offices of Saul Ewing LLP, 1500 Market Street, 38th Floor, Philadelphia, There is no meeting in July. The first meeting in 2007 will be on January 18. Probate Section members with an interest in Orphans' Court litigation and dispute resolution are welcome to join. Contact Lawrence C. Norford, Esquire at Saul Ewing LLP for further information. He can be reached at (215) 972-8417 or lnorford@saul.com.

In 2006, the Committee continued its discussion of mediation as a new and potentially valuable approach to resolving Orphans' Court disputes. The Committee also discussed certain cases of interest, other developments in the law, and possible areas where our procedures or rules could be improved upon.

New members and new ideas for future topics of discussion or for the work of the Committee are welcome.

TAX UPDATE

By JOAN AGRAN
MCCAUSLAND, KEEN & BUCKMAN

I. TREASURY REGULATIONS

Proposed Regulations on Taxation of Exchange of Property for Annuity Contract

In REG-141901-05, 71 Fed. Reg. 61441 (10/18/06), Treasury has issued proposed regulations under Code Secs. 72 and 1001 which provide guidance on the taxation of the exchange of property for an annuity contract. The proposed regulations are in response to the belief that some taxpayers are inappropriately avoiding or deferring gain on the exchange of highly appreciated property for the issuance of annuity contracts, often involving contracts issued by family members or business entities that are directly or indirectly owned by the annuitants or their family members.

Contrary to the assumptions in *Lloyd v. Comr.,* 33 B.T.A. 903 (1936), which used the open transaction approach, and Rev. Rul. 69-74, 1969-1 C.B. 43, which used the ratable recognition approach, Treasury believes transferors should be taxed in a consistent manner regardless of whether they exchange property for an annuity or sell that property and use the proceeds to buy an annuity. It is intended that Rev. Rul. 69-74 will become obsolete contemporaneously with the effective date of the proposed regulations.

The proposed regulations provide that if an annuity contract is received in exchange for property other than money, (i) the amount realized attributable to the annuity contract is the fair market value (as determined under Code Sec. 7520) of the annuity contract at the time of the exchange; (ii) the entire gain or loss, if any, is recognized at the time of the exchange, regardless of the taxpayer's accounting method; and (iii) for purposes of determining the initial investment in the annuity contract under Code Sec. 72(c)(1), the aggregate amount of premiums or other consideration paid for the annuity contract equals the amount realized attributable to the annuity contract (the contract's fair market value). Where the fair market value of the property exchanged equals the fair market value of the annuity contract received, the investment in the annuity contract equals the fair market value of the property exchanged for the annuity contract.

If the exchange of property for an annuity contract is partly a sale and partly a gift, the proposed regulations apply the same rules as are applicable to any other such exchange under Code Sec. 1001.

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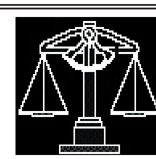
Ethics Column, continued

the interest of either the existing or prospective client and (2) inform both the existing and prospective client of the referral issue and receive their consent. This would seem to be the only way to satisfy Rule 1.7 pertaining to conflicts.

What about accepting a referral fee from the lawyer to whom the attorney refers the prospective client? Some argue it is possible to satisfy both Rule 1.5(e) pertaining to referral fees and Rule 1.7(b) pertaining to conflicts and be eligible to receive a referral fee. Once again, however, a prerequisite to the arrangement would be complete disclosure to and consent by both the existing and prospective client. It puzzles this scribe, however, that even if that has been accomplished, how one attorney may remain fully loyal to a client while having a monetary stake in the opponent's case, particularly in contingent fee matters.

The questions about the referral and the acceptance of a referral fee are vexing. When these two questions were considered recently by the Philadelphia Bar Association's Professional Guidance Committee, the Committee decided not to issue a general written opinion with respect to either question. The Committee believed each issue was too highly fact-specific. Furthermore, there was no unanimity of feeling within the Committee.



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

Tax Update, continued

The proposed regulations apply equally to secured and unsecured annuity contracts and equally to private and commercial annuities; a single set of rules would leave the transferor and transferee in the same position before tax as if the transferor had sold the property for cash and used the proceeds to purchase an annuity contract. The same rules apply whether the exchange produces a gain or loss.

The proposed regulations would not change the existing Regs. §1.1011-2 treatment of an exchange of property that is a bargain sale to a charity (including an exchange of property for a charitable gift annuity). Under these existing regulations, any gain on such an exchange is reported ratably rather than entirely in the year of the exchange. However, comments are requested as to whether in the future the tax treatment of such exchanges should be conformed to the tax treatment prescribed in the proposed regulations.

The proposed regulations do not eliminate a taxpayer's ability to structure a transaction as an installment sale under Code Sec. 453(b), as long as the transaction satisfies the other Code Sec. 453 requirements. Comments are requested on the circumstances, if any, in which an exchange of property for an annuity contract should be treated as an installment sale and on whether the Code Sec. 453 regulations need to be changed regarding those circumstances.

The proposed regulations under Code Sec. 1001 generally apply to exchanges of property for annuity contracts after October 18, 2006 and the proposed regulations under Code Sec. 72 generally apply to annuity contracts received in such exchanges after October 18, 2006. The proposed regulations delay the effective date for six months (until after April 18, 2007) if (i) the annuity contract issuer is an individual; (ii) the obligations under the contract are not directly or indirectly secured; and (iii) the property transferred in the exchange is not disposed of by the transferee during the two-year period beginning on the date of the exchange.

II. COURT DECISIONS

Gifts Reduced by Donees' Agreement to Pay Contingent Estate Tax

In *Succession of McCord, Jr. v. Comm.,* 98 AFTR 2d P2006-5373 (CA5 2006), taxpayers and their children formed a family limited partnership which held stocks, bonds, real estate, oil and gas interests, and other closely held interests. In 1996, taxpayers assigned interests in the partnership pursuant to an agreement containing a formula clause to the children, trusts for the children and grandchildren, and two charitable organizations. The children agreed to pay all transfer taxes resulting from the transaction, including the estate tax liability that would arise under the gift tax gross-up if one or both of their parents died within three years of the date of the assignments.

Later in 1996, under a second agreement, the assignees allocated the assigned interests among themselves in accordance with the formula clause, and soon thereafter the partnership redeemed the interests of the two charitable organizations pursuant to a call option in the partnership agreement.

Taxpayers timely filed gift tax returns for 1996 for their respective gifted interests. The Service assessed taxpayers, finding that the taxpayers (i) understated the gross value of their gifted interests; and (ii) improperly reduced the gross value by the actuarial value of the children's obligation to pay estate taxes potentially attributable to the transaction.

The Tax Court, in *Charles T. McCord Jr., et ux. v. Commissioner,* 120 T.C. No. 13, (No. 7048-00, 2003), increased the value of the gifts and held that the taxpayers' gifts had to be determined without reference to the contingent estate tax liability that the children assumed under the first agreement. The Fifth Circuit reversed, accepting the taxpayers' appraisal at face value and holding that the reduction for the contingent estate tax liability was proper. The Fifth Circuit found nothing speculative about the date-of-gift fact that if either taxpayer, or both, were to die within three years following the gift (as did the husband), the non-exempt donees would have been, and in actuality were, legally bound to pay the additional estate tax that could result under Code Sec. 2035.

The Service never contended that the taxpayers' expert's calculation of the net taxable value of the gifts was erroneous; only that no discount should have been taken for the Code Sec. 2035 factor. The Service also didn't dispute the tax rates, interest factor, or actuarially determined mortality factors that the taxpayers used in calculating the reduction for the potential Code Sec. 2035 tax. The only question was whether the limitation of three years on the taxpayers' exposure to the additional estate taxes imposed by Code Sec. 2035 was too speculative to be included in calculating the net taxable value of the gifts. The court found that it was not because it believed that a willing buyer would insist on the willing seller's recognition that the effect of the three-year exposure to estate taxes was sufficiently determinable as of the date of the gifts to be taken into account.

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Tax Update, continued

Duty of Consistency Requires Using Estate Tax Value for Income Tax Purposes

In *Janis v. Comr.,* No. 04-74624 (CA 9 8/21/06), and No. 04-4443-ag (CA 2 11/15/06), decedent, who died in 1989, had transferred during his lifetime his sole proprietorship in an art gallery, including approximately 500 works of art, to his revocable trust. His sons were the executors of the estate, and trustees and beneficiaries of the trust after his death.

A well-known art auction company appraised the art collection on an undiscounted item-by-item basis. On the basis of this appraisal, the estate valued the collection at $12.4 million for estate tax purposes, after applying a blockage discount that took into consideration the number of works in the collection, the nature of the works, and other factors that would affect the actual realized price. The IRS Art Advisory Panel reviewed a sample of the collection, determined the undiscounted value to be $36.6 million, and concluded that a blockage discount was appropriate. In subsequent negotiations the Service and the estate agreed upon a valuation of $14.5 million for estate tax purposes.

Three weeks after settling with the Service for estate tax purposes, decedent's sons amended the trust's fiduciary income tax returns for 1990-1992, which had originally reflected the $12.4 million value of the artwork in calculating the gain or loss on sales of some of the art, to reflect the $36.6 million undiscounted value determined by the IRS Art Advisory Panel. The sons also used this value on the 1993-1995 fiduciary income tax returns, creating large net operating losses for the gallery and increasing the trust's and the sons' income tax benefits. When the sons terminated the trust in 1995 and the gallery and art collection were distributed to a partnership formed by the sons, the trust's 1990-1995 net operating losses rolled over to the partnership.

After examining the sons' individual income tax returns for 1995-1997 and the trust's fiduciary income tax returns for 1990-1995, the Service concluded that the returns should have used the $14.5 million blockage discounted value for the art collection which value reduced the trust's net operating losses and caused the partnership to realize a profit in 1996 and 1997. The Service issued a notice of deficiency for the sons' 1995-1997 individual income tax returns. The Tax Court upheld the deficiencies, holding that the duty of consistency prevented the sons from claiming the higher, undiscounted value as the tax basis of the collection on their income tax returns. One son appealed to the Ninth Circuit while the other son appealed to the Second Circuit.

The Ninth Circuit affirmed the Tax Court's decision, holding that the duty of consistency required the parties to use the same value on the income tax returns as agreed to for estate tax purposes. The duty of consistency applies if the taxpayer made a representation or report on which the Service relied and, after the applicable statute of limitations ran out, attempted to change the previous representation or to recharacterize the situation in a way that harmed the Service. Where these factors are present, the Service may act as if the taxpayer's previous representation remains true, even if it is not, and the taxpayer is estopped to assert the contrary. The court concluded that in this case all of these factors were met.

The Second Circuit also affirmed the Tax Court's decision, noting that the Tax Court had properly rejected decedent's son's effort at tax avoidance. The court explained that fair market value on the date of death is the price that the property would have brought if sold by a willing seller to a willing buyer on that date. The court noted that this definition of value sets the standard for determining the estate tax. Citing Code Sec. 1014(a) and Regs. §1.1014-3, the court also noted that this value is used to determine the income tax due, if any, on a subsequent sale of inherited property. If the discount results in an accurate valuation of the property, the court explained that the underlying policies have been served and the same value must be applied for income tax purposes. The policy behind the stepped-up basis rule is to avoid a double tax on the pre-death appreciation in the property, which is taxed by the estate tax; decedent's son benefited from the statutory scheme where only the post-death gain is taxed on a subsequent sale of the property..

Estate Denied Charitable Deduction for Remainder Interests in Trust

In *Estate of Anthony J. Tamulis, et al. v. Commissioner,* (2006) TC Memo 2006-183, decedent, a priest, died in 2000, having created a trust that, after listing a number of specific bequests, provided, for a term to last until the later of 10 years or the joint lives of his brother and sister-in-law:

1. A life estate in the decedent's home to his brother and sister-in-law, with the remainder interest going to his grandnieces.

2. The payment of all real estate taxes during the lives of his brother and sister-in-law.

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Tax Update, continued

3. Various set amounts to be paid annually to named individuals, some with specific conditions.

4. A payment of the balance of the trust's annual net income to the decedent's two grandnieces.

At the end of the term the assets would pass to a Roman Catholic Diocese. The estate claimed a charitable contribution deduction on its estate tax return for the claimed value of a charitable remainder interest given to the diocese. The Service disallowed the charitable contribution deduction stating that the trust did not meet the requirements of Code Sec. 2055(e).

The Tax Court upheld the Service's position that the trust did not qualify as either a charitable remainder unitrust or a charitable remainder annuity trust. A charitable deduction would be permitted if the remainder interest was a reformable interest, but here the interest was not reformable because some payments made to noncharitable beneficiaries, such as the payment of real estate taxes on the decedent's home and the requirement to pay the grandnieces the balance of the trust's annual net income, were not expressed as either a specified dollar amount or a fixed percentage of the trust's fair market value, as required by Code Sec. 2055(e)(3)(C)(ii).

The only remaining method for reformation was to begin a judicial proceeding to reform the trust within 90 days after the estate tax return was due, and because no such proceeding was commenced, the remainder interest did not qualify for a deduction.

The court rejected the taxpayer's arguments that (i) the return statement amended the trust into a charitable remainder unitrust; (ii) the return statement was equivalent to commencing a judicial proceeding within the meaning of Section 2055(e)(3)(C)(iii); or (iii) the reformation provisions were met because the trust was actually managed in conformance with the charitable remainder unitrust requirements.

Tax Court Values Transfers of S Corporation Stock Where Notes Contain Self-Canceling Clauses

In *Dallas v. Comr.,* T.C. Memo 2006-212 (9/28/06), taxpayer, in November of 1999. transferred 4000 shares of nonvoting stock of an S corporation to trusts established for the benefit of his two sons in exchange for cash and promissory notes with self-canceling features. The value of the stock, $620 per share, was based on a third-party appraisal.

In November of 2000, taxpayer transferred 2,956 shares of nonvoting stock to each of the trusts for cash and a promissory note. The value of the stock was based on the 1999 appraisal with an estimated increase to $650 per share as of date of the second transfer. The 2000 notes did not have a self-canceling clause.

In 2001, after the Service told taxpayer's attorney that the 1999 notes were worth less than face value due to the self-canceling clause, the parties executed new promissory notes substantially identical to the 1999 notes but with no self-canceling clauses. The Service then determined that the value of the stock was higher than represented and that the transactions were bargain sales and therefore gifts.

On the basis of these facts, the Tax Court held that (i) the fair market value of the S stock to be $751 per share in November of 1999, and $801 per share in November of 2000; and (ii) the value of each 1999 note was $1,687,704 and not the $2,232,000 that taxpayer contended. The court, noting that intrafamily transfers are presumed to be gifts, found that the prices petitioner's sons agreed to pay for the S stock at issue were not arm's-length prices, because: (i) the transactions were for estate planning purposes; (ii) taxpayer's sons were not represented by their own counsel in the transactions; and (iii) there were no negotiations.

The Tax Court further held that taxpayer could not disavow the self-canceling clauses in the 1999 notes; the clauses were not the result of mistake, undue influence, fraud, or duress and therefore the self-canceling clauses must be given effect. As a result, the value of each of the 1999 notes was $1,687,704 as determined by the Service.

Trust Not Entitled to Charitable Deduction

In *Brownstone v. U.S.,* No. 04-4061-cv (CA 2 9/27/06), decedent's testamentary trust provided that the trustee was to distribute income and principal for decedent's wife's benefit, even to the extent of exhausting the principal. At wife's death, if she did not exercise her testamentary power of appointment, the trustee was to distribute the remaining principal to husband's and wife's foundation.

Wife's will directed that at her death the remaining trust principal be paid to her estate. After the payment of 48 cash bequests to individuals, wife's Will directed that the residue of her estate be paid to eight charities. After husband's trust paid $313,375 in income taxes for 1996, the trustee distributed $1 million to wife's estate. The trustee subsequently filed an amended 1996 income tax return seeking a refund of the taxes paid on the basis that the $1 million distribution qualified for

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a Code Sec. 642(c)(1) income tax charitable deduction. The Service refunded $74,413 but denied the remainder. Trustee protested, arguing that the trust owed no 1996 income taxes because the $1 million distribution prompted by wife's exercise of the power of appointment qualified under Code Sec. 642(c)(1), which allows a charitable deduction for gross income paid to charity "pursuant to the terms of the governing instrument." The Service disagreed and the trustee then filed suit.

On the basis of these facts, the District Court granted the Service's summary judgment motion, holding that the trust was not entitled to the Code Sec. 642(c)(1) deduction because, (i) husband's Will alone was the "governing instrument" for Code Sec. 642(c)(1) purposes; and (ii) the $1 million payment was not made pursuant to husband's Will. The Second Circuit affirmed, stating that to qualify for the Code Sec. 642(c)(1) deduction, the trust must, (i) identify the governing instrument; (ii) show that the distribution was made pursuant to that instrument; and (iii) show that the distribution was paid for a Code Sec. 170(c) charitable purpose.

In light of the precedents, the court concluded that wife's charitable distributions were not made pursuant to the governing instrument. Husband's Will allowed wife to exercise her power of appointment in any manner she saw fit and made a charitable distribution only if wife did not exercise her power. The choice was wife alone to distribute the entire principal to private individuals or to charity.

Annuities Included in Decedent's Gross Estate

In *Davenport Est. v. Comr.,* T.C. Memo 2006-215 (10/5/06), a 1991 settlement agreement resulting from a medical malpractice complaint concerning decedent's birth provided for two annuities, payable for decedent's life, compounded annually at 5%, guaranteed for 30 years. Periodic payments were to be paid to decedent's parents as co-conservators of the decedent, and any payments to be made after the death of the decedent were to be made to the person or entity as designated in writing by decedent's parents as co-conservators. The agreement stated that if no person or entity is so designated, such payments shall be made to decedent's estate.

Consistent with the settlement agreement, two commercial annuities were purchased, each providing for $2,500 monthly payments commencing November 15, 1991, increasing at a compounded 5% annually, for a minimum of 360 payments. Both annuities also indicated that decedent's estate would be the beneficiary in the event of her death before all 360 payments were made.

Following decedent's death in 2000, a Federal estate tax return was filed which, after application of the unified credit, reported that no tax was due. Schedule I, Annuities, listed the two annuities but reported that the respective includible value of each at the date of death was zero. The claimed deductions included $3,639 for "Funeral luncheon."

The probate court inventory initially reflected the estate's interest in the two annuities at a value of $1,118,000. The estate subsequently provided the IRS examiner with two amended inventories which excluded the value of the annuities. In 2004, the Service issued a statutory notice determining a deficiency of $507,103 based on the inclusion in the gross estate of the two annuities at a combined value of $1,514,572 and the disallowance of the funeral luncheon expense.

On the basis of these facts, the Tax Court held that (i) the two annuities payable under the settlement agreement are includible in the gross estate pursuant to Code Sec. 2033; (ii) for purposes of inclusion in the gross estate, the annuities are to be valued under Code Sec. 7520 in accordance with the actuarial valuation methodology of Regs. §20.2031-7(d); and (iii) expenditures incurred for the funeral luncheon are not properly deductible as funeral expenses under Code Sec. 2053(a)(1).

In considering the inclusion of an annuity in the gross estate, the question was whether, and to what extent, decedent held a beneficial interest in the annuities at the time of her death. The court found that the decedent held at least some beneficial interest in the annuities and therefore the annuities were includible in decedent's gross estate under Code Sec. 2033.

As to the funeral luncheon expense, the Tax Court stated that the basis of the funeral expense deduction is reasonableness and the necessity of the expense in connection with the decedent's funeral. Because the record offered nothing but the total line-item figure of $3,639, the court found that it lacked any basis whatsoever for determining reasonableness and therefore the funeral luncheon was not properly deductible under Code Sec. 2053(a)(1).

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Deduction for Investment Advisory Fees Paid by Trust is Subject to 2% Floor

In *Rudkin Testamentary Trust v. Comr.,* No. 05-5151-ag (CA 2 10/18/06), a trust established by decedent for his son's benefit, claimed a deduction of $22,241 on its 2000 Form 1041 for investment-management fees paid to an advisory firm hired by the trustee as a deduction not subject to the Code Sec. 67(a) 2% floor applicable to miscellaneous itemized deductions.

In 2003, the Service issued a notice of deficiency, permitting a deduction for only $9,976 of the fees, which was the portion of the fees in excess of 2% of the trust's adjusted gross income. The trustee disputed the assessment, claiming that the trustee's fiduciary duties regarding prudent investments required investment advisory services for the proper administration of the trust's stock portfolio and were therefore fully deductible under Code Sec. 67(e)(1).

The Tax Court held that the fees were deductible only to the extent they exceeded 2% of the trust's adjusted gross income pursuant to Code Sec. 67(a). The Second Circuit affirmed, holding that Code Sec. 67(e)(1) unambiguously exempts from the Code Sec. 67(a) 2% floor only those costs incurred by a trust that could not have been incurred if an individual held the property.

Code Sec. 67(e) provides that an estate's or trust's adjusted gross income is computed in the same manner as an individual's, subject to one exception; the exception specifies that "costs which are paid or incurred in connection with the administration of the estate or trust and which would not have been incurred if the property were not held in such trust or estate" are fully deductible in computing adjusted gross income. As to individuals, Code Sec. 212 and Regs. §1.212-1(g) generally treat investment advisory fees as itemized deductions and, because Code Sec. 67(b) does not specifically exempt such fees from the 2% floor, the fees are subject to the 2% floor.

Citing *O'Neill v. Comr.,* 994 F.2d 302 (CA 6 1993), Mellon Bank v. U.S., 265 F.3d 1275 (Fed. Cir. 2001), and Scott v. U.S., 328 F.3d 132 (CA 4 2003), the court noted that the circuits are split on whether such fees satisfy the requirement that they would not have been incurred if the property were not held in trust, with the Federal and Fourth Circuits holding that such fees are subject to the 2% floor and the Sixth Circuit holding that they are not. The court joined with the Fourth and Federal Circuits, holding that Code Sec. 67(e)(1) does not exempt a trust's investment advisory fees from Code Sec. 67(a)'s 2% floor.

Property Included in Decedent's Estate Where Implied Agreement to Keep the Economic Benefits

In *Stewart Est. v. Comr.,* T.C. Memo 2006-225 (10/24/06), decedent and her son resided in the first two floors of a residence that she owned in New York City. Beginning in October 1999, decedent leased the remaining three floors of the residence to an unrelated third party. In May 2000, decedent transferred a 49% interest in the residence to her son, which he then held with her as a tenant in common. From May until her death in November 2000, decedent continued to receive all of the rental payments from the tenant and paid most of the expenses relating to the residence.

In August 2001, decedent's executors filed a federal gift tax return relating to the transfer of the residence and in February 2002, the executors filed the federal estate tax return. In December 2004, the Service issued separate statutory notices of deficiency relating to both returns.

On the basis of these facts, the Tax Court held that, (i) the transfer of the interest in the residence was a completed gift; (ii) the full value of the residence must be included in decedent's estate under Code Sec. 2036(a); (iii) no deduction is allowed to the estate for property taxes paid by son relating to decedent's 51% interest in the residence; and (iv) no deduction is allowed for a debt owed to son relating to an agreement, between son and decedent, to share the income and expenses relating to the residence.

The Tax Court stated that decedent's retention of the property's income stream after the residence was transferred was "very clear evidence that the decedent did indeed retain possession or enjoyment." Although son contended that he and decedent agreed they would share the income and expenses in a manner reflective of their ownership interests and that he and decedent intended to perform a financial reconciliation to ensure that the proper amount of income and expenses was allocated to decedent's and son's interest in the residence, the court found, (i) there was no written agreement to reconcile the income and expenses; (ii) son's accountant testified that he did not recall being informed about an agreement to reconcile the income and expenses; and (iii) son's testimony relating to an oral agreement was not credible. Rather, the court found that son and decedent had an implied agreement that decedent would retain the economic benefits of the residence and therefore the full value of

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the residence must be included in decedent's estate under Code Sec. 2036(a).

After decedent's death, son paid $10,153 in property taxes relating to decedent's 51% interest in the residence for which the estate claimed a deduction. The court found that at the time of her death, decedent did not have an outstanding property tax obligation relating to her 51% interest in the residence; under Code Sec. 2053(c)(1)(B), the property taxes were not an enforceable obligation of decedent's at the time of her death, and no deduction was allowed.

Finally, as to the claimed deduction for a debt owed to son relating to the purported reconciliation agreement between son and decedent to share the income and expenses, citing Code Sec. 2053(c)(1)(A), the court noted that an estate may deduct the value of a claim based on a decedent's promise to pay only if the liability was contracted bona fide and for adequate and full consideration in money or money's worth. Because the court concluded that there was no reconciliation agreement, no deduction was allowed.

III. IRS REVENUE RULINGS, REVENUE PROCEDURES, NOTICES & INFO LETTERS

Guidance on Income Tax Result of Transfer of Savings Bonds to Grantor Trust

In IRS Info. Letter 2006-0056, the Service has clarified the circumstances under which the transfer of U.S. savings bonds to a grantor trust may result in the requirement that accrued interest be reported. In general, the owner of EE series savings bonds may defer reporting the accrued interest on the bonds until the earlier of when the bonds are cashed, mature, or are disposed of. If the owner of savings bonds transfers them to a trust, and the transferor is considered the owner of the trust for federal income tax purposes, the transferor may continue to defer reporting interest accrued each year until the earlier of when the bonds are cashed or finally mature.

If the bonds were issued in "husband and wife" form and were purchased with the funds of both spouses, the husband and the wife will not need to include the accrued interest in their income when the bonds are transferred to the trust. If the savings bonds were purchased with the funds of only one of the owners, the accrued interest must be reported by the individual who contributed the funds. In this situation if the bonds are reissued solely in the name of the other co-owner's name, or in the name of the other co-owner's grantor trust, the reissuance is considered a disposition of the bonds and the transferor must include the total interest accrued in his income.

If savings bonds that were issued to co-owners, where only one co-owner contributed the funds, are reissued solely in the name of the co-owner who contributed the funds, or in the name of the contributor's grantor trust, the reissuance is not considered a disposition of the bonds and the transferor may continue to defer reporting interest accrued each year.

Transitional Guidance on New Qualified Appraiser Standards

In Notice 2006-96, I.R.B. 2006-46, the Service provides transitional guidance relating to the definitions of "qualified appraisal" and "qualified appraiser", to enable taxpayers to comply with the new substantiation requirements established by the Pension Protection Act of 2006, P.L. 109-280 (2006 PPA) for non-cash charitable contributions. The new law contemplates that regulations under Code Sec. 170(f)(11) will be issued but until those regulations are effective, taxpayers may rely on Notice 2006-96 to comply with the new provisions. Notice 2006-96 applies to contributions of property (other than readily valued property within the meaning of Code Sec. 170(f)(11)(A)(ii)(I)) by individuals, partnerships, or corporations for which a deduction of more than $5,000 is claimed on returns filed after August 17, 2006.

An appraisal will be treated as a qualified appraisal within the meaning of Code Sec. 170(f)(11)(E) if the appraisal complies with all of the requirements of Regs. §1.170A-13(c) (except to the extent the regulations are inconsistent with Code Sec. 170(f)(11)), and is conducted by a qualified appraiser in accordance with generally accepted appraisal standards. An appraisal will be treated as having been conducted in accordance with generally accepted appraisal standards within the meaning of Code Sec. 170(f)(11)(E)(i)(II) if the appraisal is consistent with the substance and principles of the Uniform Standards of Professional Appraisal Practice, as developed by the Appraisal Standards Board of the Appraisal Foundation.

A "qualified appraiser" is an individual who has earned an appraisal designation from a recognized professional appraisal organization, or has otherwise met minimum education requirements. An appraiser will be treated as having earned an appraisal designation from a recognized professional appraiser organization within the meaning of Code Sec. 170(f)(11)(E)(ii)(I) if the appraisal designation is awarded on the basis of demonstrated competency

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in valuing the type of property for which the appraisal is performed. The determination of whether an appraiser is qualified must be based on the appraiser's qualifications as of the date the appraisal is made.

For real property an appraiser will be treated as having met minimum education and experience requirements if (i) for returns filed on or before October 19, 2006, the appraiser is qualified as a "qualified appraiser" within the meaning of Regs. §1.170A-13(c)(5); and (ii) for returns filed after October 19, 2006, the appraiser is licensed or certified for the type of property being appraised in the state in which the appraised real property is located.

For property other than real property an appraiser will be treated as having met minimum education and experience requirements if (i) for returns filed on or before February 16, 2007, the appraiser is qualified within the meaning of Regs. §1.170A-13(c)(5); (ii) for returns filed after February 16, 2007, the appraiser has successfully completed college or professional-level course work that is relevant to the property being valued, obtained at least two years of experience in the trade or business of buying, selling, or valuing the type of property being valued, and fully described in the appraisal the appraiser's education and experience that qualify the appraiser to value the type of property being valued.

An appraiser will be treated as having demonstrated verifiable education and experience in valuing the type of property subject to the appraisal within the meaning of Code Sec. 170(f)(11)(E)(iii)(I) if the appraiser makes a declaration in the appraisal that, because of the appraiser's background, experience, education, and membership in professional associations, the appraiser is qualified to make appraisals of the type of property being valued.

For returns filed after February 16, 2007, the declaration required under Regs. §1.170A-13(c)(5)(i) must include an additional statement that the appraiser understands that a substantial or gross valuation misstatement resulting from an appraisal of the value of property that the appraiser knows, or reasonably should have known, would be used in connection with a return or claim for refund, may subject the appraiser to a civil penalty under Code Sec. 6695A.

IV. IRS PRIVATE LETTER RULINGS AND TECHNICAL ADVICE MEMORANDA

Status of Disposition of Marital Trust Determined

In PLR 200628007, decedent created a revocable trust which at his death divided into a marital trust and a family trust. Wife and a bank are co-trustees of both trusts. At wife's death, the remaining assets of the marital trust will be divided into shares for decedent's descendants. Pursuant to a local court order, the marital trust was fractionally divided into two separate trusts, a GST exempt trust and GST non-exempt trust. An election was made on the estate tax return to treat both marital trusts as QTIP under Code Sec. 2056(b)(7).

The trustees have petitioned the local court to divide the GST non-exempt marital trust into two trusts, conditioned upon the receipt of a favorable IRS ruling. Both trusts will be held under the terms of decedent's trust agreement, the first to be funded with 75% of the GST non-exempt assets and the second to be funded with the balance. To the extent possible, the trustees will fund the trusts on a pro rata basis. After the trusts are funded, wife plans to renounce all of her interests in the smaller trust, which renunciation will not be a Code Sec. 2518 qualified disclaimer. Decedent's children and the trustees have agreed that the children will pay all resulting gift taxes if wife renounces all of her interests in the trust, so that the resulting transfers by wife will be treated as net gifts and wife will have no responsibility for the gift taxes. Based on state law and decedent's trust agreement, the trustees have asked the court to find that wife's renounced interest in this trust will pass as if wife had died on the date of her renunciation and, consequently, that trust will terminate and the remainder will pass to decedent's children.

On the basis of these facts the Service ruled that:

(i) The proposed division of the GST non-exempt trust will not affect the QTIP status of any of the marital trusts under Code Sec. 2056(b)(7)(B)(v).

(ii) Wife's renunciation of her qualifying income interest in the smaller GST non-exempt trust will be treated under Code Sec. 2519 as a transfer by wife of all interests in that trust other than her qualifying income interest. Under Regs. §25.2519-1(c)(1) and (4), wife's gift will equal the fair market value of the trust on the date of the disposition (including any accumulated income), less the value of wife's qualifying income interest in the property on the date of the disposition and less the gift tax attributable to the transferred property.

(iii) Wife will make a gift under Code Sec. 2511 when she renounces her qualifying income interest

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in the trust equal to the fair market value of her qualifying income interest on the date of disposition, less the gift tax attributable to the qualifying income interest actually paid by decedent's children.

(iv) After wife's renunciation, no part of the trust deemed transferred under Code Sec. 2519 will be included in wife's estate pursuant to Code Sec. 2044(b)(2).

(v) Wife's renunciation of her entire interest in the trust will not result in a transfer under Code Sec. 2519 of any of the assets of the remaining marital trusts.

Gifts Excluded for Federal Gift Tax Purposes

In PLRs 200633015-017, husband and wife established separate irrevocable trusts for the benefit of three grandchildren. Under the terms of each trust, the trustee may distribute any part or all of the income and principal of the trust to or for the benefit of the grandchild for whom the trust was established during the grandchild's lifetime. With respect to the first two trusts, if the grandchild dies prior to reaching age 21, the corpus is to be distributed pursuant to the grandchild's exercise of a testamentary general power of appointment. With respect to the third trust, if the grandchild dies prior to reaching age 21, the grandchild may, with the consent of a trustee who is not an adverse party, appoint the accumulated income and corpus of the trust to the grandchild's estate. To the extent the trust corpus is not appointed by the primary grandchild, the trustee may distribute any part or all of the income and corpus to the grandchild's descendants, or if none, then to the grandchild's siblings and their descendants, or if none, then to other beneficiaries who may include non-skip persons, as defined in Code Sec. 2613(b).

Upon reaching age 21, each grandchild has the right to terminate his or her trust. If the grandchild does not exercise this right within 60 days after receiving notice, the right to terminate will lapse and the trust continues. The trusts each provide that after the grandchild attains age 21, any person may make a contribution to the trust for which the grandchild has a right of withdrawal which lapses if not exercised in a stated time period. Upon the grandchild's death, the trust corpus is to be distributed pursuant to the grandchild's exercise of a testamentary special power to appoint trust principal to husband and wife's descendants.

Husband and wife made transfers of cash to all three trusts. In each case, the transfer made in a calendar year to each trust did not exceed the Code Sec. 2503(b) gift tax annual exclusion for that year. All three grandchildren are currently under the age of 21.

On the basis of these facts, the Service ruled that:

(i) From the date of its inception through the date the primary beneficiary reaches age 21 (the initial contribution period), each trust satisfies the requirements of Code Sec. 2503(c) and therefore, husband and wife's contributions to all three trusts are excluded in each tax year from the respective donor's total gifts for federal gift tax purposes. Further, all of husband and wife's future contributions to each trust during the initial contribution period will be excluded from the respective donor's total gifts for federal gift tax purposes, except to the extent any contributions exceed the amount described in Code Sec. 2503(b).

(ii) Each trust is a Code Sec. 2613(a) skip person with respect to husband and wife during the contribution period. Accordingly, all contributions by husband and wife to the trusts, were Code Sec. 2612(c) direct skips, and any further contributions by husband and wife to the trusts during this period will be direct skips. In accordance with Code Sec. 2632(b)(1), husband and wife's unused GST exemption was automatically allocated to contributions by husband and wife to the trusts to the extent necessary to make the inclusion ratio for such property zero. The Service expressed no opinion concerning the application of Code Sec. 2642(c)(2) to the trusts, most likely because the requirements of this section are met only until the grandchild attains age 21.

Pecuniary Bequests to Charities Paid From IRA Result in IRD to Trust

In CCA 200644020, decedent designated his revocable trust as the beneficiary of his IRA. The trust provided that upon decedent's death, $100,000 was to be distributed "in cash or in kind" in set amounts to three charities with the remaining principal of the trust distributed to decedent's children

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outright or in trust as provided in the document.

The trustee was given the discretion and power to make distributions or divisions of principal in cash or in kind, or both, at fair market values at a date of distribution fixed by the trustee, without any requirement that each item be distributed or divided ratably. The trustee instructed the IRA custodian to divide the IRA into shares titled in the names of the three charities who were the named recipients of the pecuniary legacies under the trust, thereby resulting in each of the charities becoming the owner and beneficiary of an IRA equal in value, at the time of division, to the dollar amount it was entitled to under the trust.

On the basis of these facts, the Chief Counsel's Office advised that the balance in the IRA at decedent's death, less any nondeductible contributions, is IRD under Code Sec. 691(a)(1). Citing Kenan v. Comr., 114 F.2d 217 (CA 2 1940), the Chief Counsel stated that if an estate or trust satisfies a pecuniary legacy with property, the payment is treated as a sale or exchange. Because the trust used the IRA to satisfy its pecuniary legacies, the trust must treat the payments as sales or exchanges and therefore, under Code Sec. 691(a)(2), the payments are transfers of the rights to receive the IRD and the trust must include in its gross income the value of the portion of the IRA which is IRD to the extent the IRA was used to satisfy the pecuniary legacies. Because the terms of the trust do not direct or require that the trustee pay the pecuniary legacies from the trust's gross income, the transfer of a portion of the IRA in satisfaction of the pecuniary legacies does not entitle the trust to a deduction under Code Sec. 642(c)(1).