REPORT OF THE CHAIR
BY RISE NEWMAN, ESQUIRE | DRUCKER BECKMAN SOBEL, LLP

It has been a privilege to serve as your Chair.

Even after attending what was most likely my 30th Executive Committee meeting, I still marvel at the energy, integrity, compassion, and creativity that the active members bring to our Section. We are fortunate to be involved in an area of the law that is constantly changing and continually demands our focus and talent.

In the tradition of our quest for learning, the CLEs, meetings and presentations continue. On October 9 we had our Quarterly Meeting and CLE. The topic was Will Contests: What Have I Gotten Myself Into? It was a very well presented CLE thanks to The Honorable Anne E. Lazarus, Jennifer D. Gayle, and Adam T. Gusdorff. Thanks, as well, to Justin Brown (our Chair-Elect) and law student Chloe Mullen-Wilson (a 3rd year law student) for planning such a lively and well-attended event.

On October 12, former Section Chair Robert H. Louis along with James R. Malone, Jr. and Ku Yoo presented an excellent CLE titled “Estate Planning for the Solo and Small Firm Practitioner: “How to Plan During Your Lifetime and How to Administer a Practice Upon Death”. Many of the attendees were trial attorneys. The presentation was effective, and all attendees were very engaged. A very successful CLE thanks to the planning efforts of Chair-Elect, Justin Brown, and Maureen M. Farrell, Chair of the Solo and Small Firm Practice Group.

On the horizon we have our annual Tax Committee event with representatives from the Pennsylvania Department of Revenue Inheritance Tax Department. The meeting will be held October 23. This month, the Orphans’ Court Litigation and Alternative Dispute Resolution Committee will hold their annual meeting with the law clerks. That always promises to be a well-attended event.

Our ever-growing Technology Committee has a lunch and learn program planned titled “Estate Planning with Digital Assets”. The program is wait list only! We continued on page 3

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:

Michael Breslow
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Wealth | A Personal Approach

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REPORT OF THE CHAIR, CONTINUED

are so thrilled to have this robust committee helping to steer our practices into the future. Thank you Chair Ross Bruch for planning and thank you Chair-Elect Justin Brown and Legislative Committee Chair Jennifer Zegel for planning and presenting.

Speaking of our Legislative Committee, thank you to John Stinson for chairing the committee during his days in private practice and thank you Jennifer Zegel for taking over as chair. The committee is very busy with tackling some legislation involving Inheritance Tax liens and also legislation concerning financial institutions and financial exploitation of the elderly. Rebecca Rosenberger Smolen is involved with addressing our practice issues regarding POD/TOD accounts and is currently looking into how other states are addressing the issue.

We welcome Bradley Newman as our new Chair of the Elder Law and Guardianship Committee. Bradley stepped-in to chair the committee as our colleague and former Committee Chair, Anastasia De-Paz, stepped away from private practice and into the public sector. Bradley will be focusing his work on developing ways to address some of the issues surrounding guardianship work. I am pleased to say that I will be working with Bradley and some others on this matter.

I hope that all of our members joint us at our Annual Meeting! This year the Meeting will be held on November 29th at the Courtyard by Marriott Philadelphia Downtown.

Our Section’s flurry of activity would not be possible without the dedication and grit of my officers: Chair-Elect, Justin Brown, Vice-Chair, Scott Small, and Secretary, Heike Sullivan. Thank you for your kindness, your humor, and your graciousness.

To my Executive Committee, I will miss seeing your friendly faces and hearing your voices. I will certainly miss my personal challenge of keeping our meetings to under 55 minutes.

Thank you, again, for the honor to serve as Chair of this Section. I leave you in capable hands. I will see everyone on November 29th!

JOIN A COMMITTEE

The Section’s committees depend on the steady flow of people, energy and ideas. Join one!

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As is often the case, the practical interpretation of the well written terms set forth in a Trust Agreement or a Will falls to the Trustee. In fulfilling its duty to carry out the Grantor's intent, while managing Beneficiary expectations, the Trustee can sometimes be in an awkward situation. The Philadelphia Corporate Fiduciaries organization (Corporate Fiduciaries) thought it would be helpful to share its perspective as it interprets certain trust terminology relative to trust administration. (*The use of “Grantor” throughout this article is meant to include “Testator”.)

A collaboration between the drafter and the Trustee in setting family expectations would be well-received. The Grantor and the Beneficiary will benefit from appropriate education as to the interpretation of certain trust provisions and as to trust administration mechanics. In this article, Corporate Fiduciaries has addressed three areas, namely:

- Importance of Understanding the Family
- Understanding the Trust Distribution Terms and the Process
- Drafting for the Role of the Trustee

There will of necessity be some overlap between these three areas, as Corporate Fiduciaries discusses each of these.

**Importance of Understanding the Family**

Regardless of whether the Trustee appointed to serve on a new trust (or appointed to serve as a successor trustee on an existing trust) is an individual or a corporate trustee, it is extremely important for the Trustee to understand the family dynamics, the provisions of the trust agreement, the purpose of the trust and the goals of the Grantor.

The Trustee should engage in a conversation with the Grantor and/or the drafting attorney to secure family tree information, including dates of birth and death, marital status, adoption or “step” relationships and current addresses.

In today’s highly regulated business environment, corporate fiduciaries need to fulfill “Know Your Customer” (KYC) requirements. KYC extends not only to the Grantor but to any party associated with the trust who is perceived to have a controlling or beneficial interest. This would include Co-Trustee, Investment Advisor, Distribution Advisor, Trust Protector and Beneficiary. The corporate fiduciary will be seeking information required by law, which for individuals includes date of birth, tax identification number and current address. In addition, many fiduciaries are required to seek information including:

- source of wealth
- occupation, if retired, occupation at retirement
- citizenship (place of birth)
- telephone number
- net worth
- copies of valid picture ID (drivers’ license or passport)

continued on page 5
Once the KYC information is obtained, the information is required to be verified by the fiduciary. There are many methods of doing so, including the use of various third-party resources which search national and international databases to corroborate the submitted information.

The Trustee also should engage in a conversation with the Grantor and / or the drafting attorney to understand the existing family dynamics and any family issues that will impact the administration of the trust, such as, to name a few:

- substance abuse
- health issues
- excessive spending habits,
- mental capacity
- family governance issues (i.e. recognized family “patriarch/matriarch” and succession considerations for family spokesperson)

Understanding the family dynamics and family issues are important for the Trustee to help ensure the Grantor’s goals are met.

It goes without saying that the Trustee must become conversant with the trust provisions so as to be able to administer the trust and answer beneficiary questions.

The Trustee also should be knowledgeable as to the estate, generation-skipping transfer and income tax regulations that impact the trust administration. If the Trustee is not personally knowledgeable of the tax treatment, the Trustee should align himself/herself with a tax expert so as not to run afoul of the trust tax issues.

Lastly, the Trustee should engage in a conversation with the Grantor and/or the drafting attorney to understand the purpose of the trust and the goals of the Grantor. Is this a trust meant to last for successive generations of the family? Is the trust meant to primarily benefit the current beneficiary generation which requires a more generous interpretation of the distribution standards? Is this trust meant to encourage certain beneficiary behavior? While trusts can be very flexibly drafted, guidance as to the Grantor’s intent is critical to the Trustee for proper trust management. Often, a family meeting can facilitate discussion of the trust purpose and the Grantor’s goals which can set family expectations and enhance proper trust administration.

**Understanding the Trust Distribution Terms and the Process**

Applying the discretionary distribution standard is one of the most challenging tasks of the Trustee. When creating a trust, the Grantor should be clear as to why the trust is being created and have a good understanding of the Beneficiary’s needs and circumstances. The Grantor should think about the types of distributions the Grantor wants a Beneficiary to receive, the purposes for which a Beneficiary can request a distribution, the priority of distributions, the circumstances that need to exist and be considered in order for a distribution to occur, who the decision makers should be and what measures the decision makers should use to evaluate the Beneficiary’s needs for the distribution. An understanding of the Grantor’s intent regarding all of these considerations will better assist the Trustee in balancing the needs of the Beneficiary and administering the trust. While many attorney drafters will undertake these discussions with the Grantor, it is often helpful to engage a trust professional for their perspective on these distribution questions. In particular, if the Trustee is to be an individual with no fiduciary experience, these conversations are most helpful. A corporate trustee appreciates the opportunity to help educate/guide the Grantor, the Co-Trustee and the Beneficiary as to these distribution issues if, at all possible, prior to the execution of the trust.
There are various distribution standards which may be found in a trust and which can be summarized as: Ascertainable Standard, Unascertainable Standard and Absolute Discretion.

**Ascertainable Standard: Objective and Measurable** (Often relates to current standard of living while recognizing aspirations)

Health, Education, Maintenance and Support (HEMS) as referenced in Internal Revenue Code.

Medical/Dental issues may be routine or emergency—one time or ongoing:

- Psychiatric, psychological treatments,
- Eye care, lasik surgery,
- Health, dental or vision insurance;
- Home health care; gym or spa memberships, health retreats

Grantor can limit any of the above

**Education Standard** can include:

- All levels of education from elementary, secondary to high school;
- Graduate and post graduate;
- Career training, Technical, Professional or medical, or law schools

- Support while in school, including housing, transportation
- Camps, internships, experiences abroad

Grantor may consider limiting the endless possibilities of levels of education.

- Maintenance & Support can be considered synonymous
- Not limited to bare necessities
- Real Estate expenses (mortgage and tax payments)
- Health/Life insurances
- Continued accustomed vacation
- Gifting (if a pattern has been established)
- May include reasonable comforts or luxuries

Grantor may consider support obligations and extending beyond the named Beneficiary (i.e. support for others living in the same household)

**Unascertainable Standard: Broader than HEMS**

- Comfort, happiness, best interest, welfare or benefit

Careful consideration in using this standard when a Beneficiary is also the Trustee because of the estate inclusion issue.

**Absolute Discretion: Greatest flexibility**

- Some jurisdictions allow for total return, decanting, modification of trust terms, termination, etc. if the trust grants absolute discretion. (It should be noted that there are some jurisdictions that allow these techniques if less than absolute discretion is granted)

Once a conversation has been had regarding the “why” as to the trust’s distribution standard, it is also recommended that there be a conversation regarding the “how” as to trust distribution mechanics. Often, the trust agreement provides that distributions are initiated by a “written” request from the Beneficiary. All trustees, and in particular corporate trustees, have a process in place for reviewing such requests, making an evaluation as to appropriateness in light of the trust terms, distribution history and the like, and will eventually either facilitate payment or document the denial of the request.

For example, the Corporate Trustee Approach:

1. Once a request (written or email) is received from the Beneficiary, the Trustee gathers information on the amount;

**continued on page 7**
reason for the request; the timing of the distribution; Beneficiary’s financial situation (which can include a net worth statement, budget as to expenses / income, income tax returns, etc.). The Grantor can modify this information gathering process by including in the trust agreement a specific provision that the Beneficiary’s financial condition and other resources NOT be considered when dealing with a distribution request.

2. The Trustee reviews the trust terms as to relative criteria vis-à-vis distribution standards, Beneficiary loans, approval from a Trust Protector or Distribution Advisor, etc.

3. The Trustee considers the impact of this distribution on other current beneficiaries, the remainder beneficiaries and the overall sustainability of the trust over the trust’s intended term.

4. The Trustee reviews the impact upon the assets in the trust with respect to this distribution request. Is there cash available or will assets need to be sold to produce the cash, and, if so, will a capital gain/loss be recognized. How will this distribution effect the trust’s overall asset allocation and performance?

5. The Trustee prepares a report in support (or not) of the request. Such reports are often reviewed internally by senior fiduciary officers or a discretionary distribution committee comprised of senior fiduciary officers for ultimate approval or rejection.

6. Upon final approval, the distribution is made to the Beneficiary in the manner requested (check, wire, etc.) While multi-year distribution requests can be contemplated, reviewed, evaluated and payments scheduled, typically each request is reviewed on its own merits which results in opportunities for further conversation with the Beneficiary.

Understanding this process will help set expectations as to the management of distribution requests.

Drafting for the Role of the Trustee

It is assumed that the drafter will have a discussion with the Grantor as to the choice of Trustee and the importance of the selection. Whether the Trustee be a family member, family friend, family advisor or corporate fiduciary, the Trustee’s duties, responsibilities and liabilities are significant. The position is not for the “faint hearted”. The more flexibility and trustee discretion included in the terms of the trust agreement, the more important trustee selection becomes.

While a corporate trustee is deemed to have the expertise to provide the myriad of services associated with proper trust administration, not all corporate trustees are created equal. Careful vetting of the services offered by corporate trustees should be undertaken in the trustee selection process.

As previously mentioned, the effectiveness of the trust administration is enhanced by the Trustee being informed as to the family dynamics. When 2 or more trustees are serving, well written trust agreements should contain provisions regarding how tie votes are decided, how duties may be delegated between the trustees then serving and how trustees can be changed in appropriate circumstances (i.e. mental capacity of trustee is in question, continued conflict between co-trustees, etc.) The clauses that deal with trustee resignation, succession and the removal and replacement of corporate trustees should be clearly written and reviewed with the Grantor. In some cases, it is beneficial for the Grantor to have a conversation with the contemplated Trustee to review the duties, responsibilities and liabilities of the position.

Currently, given the increased federal lifetime exemption available
COORDINATING TRUST AGREEMENTS, CONTINUED

to Grantors, state income tax planning has become more and more important. Care should be given in the selection of trustees as to the fiduciary income tax implications of the residence of the Trustee. In some states, the taxability of the trust is controlled by the residency of the Trustee, not the residency of the Grantor, Beneficiary or situs of the trust administration. For example, a Pennsylvania resident Grantor who names as co-trustees, a Pennsylvania corporate Trustee and Grantor’s child, who happens to be a resident of California, subjects the Pennsylvania trust to California fiduciary income taxes as well as Pennsylvania taxes because California taxes trusts based upon the residency of the Trustee. The attorney drafter should be prepared to have this conversation with the Grantor. The Grantor should not hear about this tax implication for the first time from the corporate Trustee administering the trust.

The fee clause as it relates to Trustee services should also be carefully crafted and the options discussed with the Grantor. What is intended when an attorney providing legal services is also named as a Trustee entitled to a Trustee’s fee? What is the appropriate allocation of trustee fees as between a corporate Trustee and an individual serving as Co-Trustee? How long is the trust expected to last recognizing that the level of services can change over-time and the costs of those services can also change over time? What assets are held by the trust that might require specialized services that need to be considered in setting trustee’s fees? While fees can be negotiated, most corporate trustees have standard fee schedules in effect from time to time and have a practice regarding allocation of fees as between Co-Trustees. Again, clear communication about these issues as between the attorney drafter, Trustee and Grantor will appropriately set family expectations and will benefit the orderly administration of the trust.

In conclusion, Corporate Fiduciaries hope that this article has demonstrated the importance of including the Trustee in the trust planning, trust drafting and trust administration conversations with the Grantor, Co-Trustees and Beneficiaries. Such collaboration will positively impact the efficient and proper trust administration to the benefit of the client family.

Information presented is for educational purposes only and was prepared from sources believed to be reliable, but is not guaranteed as to accuracy. The views and opinions expressed in this presentation are not necessarily those of Wilmington Trust Company, Inc. or any affiliates, or Brown Brothers Harriman Trust Company of Delaware, or its affiliates or The Glenmede Trust Company, NA or its affiliates.
CASE SUMMARY FROM THE ORPHANS’ COURT LITIGATION COMMITTEE

Fielding v. Commissioner of Revenue, 916 N.W.2d 323 (Minn. 2018), aff’g 2017 WL 2484593 (Minn. Tax Ct. May 31, 2017)

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

Pennsylvania imposes a 3.07% income tax on retained income and capital gains of any trust that is a “Resident Trust.” 72 P.S. § 7302(a). A resident trust is either: “[1] [a] trust created by the will of a decedent who at the time of his death was a resident individual; [or] [2] [a]ny trust created by, or consisting in whole or in part of property transferred to a trust by a person who at the time of such creation or transfer was a resident.” 72 P.S. §7301(s).

The constitutionality of Pennsylvania’s “settlor-based” resident trust test was successfully challenged in McNeil Trusts. In McNeil Trusts v. Com., 67 A.3d 185 (Pa. Commw. Ct. 2013), a Pennsylvania resident created two inter vivos trusts in 1959 appointing a Delaware trustee and provided in each trust instrument that the situs of the trust was Delaware and Delaware law governed. None of the trustees of the trusts resided in Pennsylvania, there was no Pennsylvania asset or Pennsylvania-source income and none of the administration occurred in Pennsylvania. However, all beneficiaries resided in Pennsylvania. The trustees had discretion to distribute principal and income to the beneficiaries. The Pennsylvania Commonwealth Court held that, under these circumstances, that the imposition of Pennsylvania income tax on the trusts violated the Commerce Clause.

In response, Pennsylvania modified its instructions to the Pennsylvania fiduciary income tax return (PA-41) to provide that “[a] n inter vivos trust or a testamentary trust created by a resident can become a nonresident trust if the settlor is no longer a resident or is deceased, and the trust lacks sufficient contact with Pennsylvania to establish nexus. Any one of the following conditions provides sufficient contact for a resident trust to remain a resident trust or to requalify as a resident trust:

• The trust has a resident trustee;
• Any trust administration occurs in Pennsylvania;
• Trust assets include:
  ° Real or tangible personal property located within Pennsylvania, or
  ° Stock, securities or intangible personal property, evidence by the documents, certificates or other instruments that are physically located, or have a business situs within Pennsylvania; or
• The situs of the trust is Pennsylvania as provided in 20 PA. C.S. §7708."

However, recent taxpayer-favorable cases in other jurisdictions have called into question whether “settlor-based” resident trust tests are constitutional at all, most recently in Fielding v. Commissioner of Revenue, 916 N.W.2d 323 (Minn. 2018), aff’g 2017 WL 2484593 (Minn. Tax Ct. May 31, 2017). Like Pennsylvania, Minnesota has a

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1 The Orphans’ Court Litigation and Dispute Resolution Committee will provide summaries of recent litigation cases in each quarterly newsletter.

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“settlor-based” test to determine a resident trust for irrevocable trusts created after December 31, 1995. Minn. Stat. §290.01, subd. 7b(a).

In Fielding, a Minnesota grantor created four irrevocable grantor trusts in 2009, one for the benefit of each of his children. After he created the trusts, the grantor transferred shares of nonvoting common stock of a Minnesota S corporation to the trusts. For two years, the trusts were “grantor” trusts, and therefore all income and capital gains were taxable to the grantor. Effective in 2012, the trusts ceased to be grantor trusts (because the grantor released his power to exchange trust assets). Accordingly, after the trusts ceased to be grantor trusts, the trusts became “resident trusts” under Minnesota law pursuant to Minnesota’s “settlor-based” test.

The trusts never had a Minnesota trustee at any time. In the tax year in question (2014), all of the trusts’ records were maintained out of state. No administration for any of the trusts occurred in Minnesota. The trusts had never been involved in any legal action in Minnesota (it is not clear whether the governing instruments for the trusts stated where the trusts’ situs was located, although the governing instruments provided that the trusts were governed by Minnesota law). For three of the trusts, the primary beneficiary was not domiciled in Minnesota in the year in question. The primary beneficiary of the fourth trust was domiciled in Minnesota in the year in question.

In 2014, the trusts sold the Minnesota S Corporation stock, realizing gain. Each trust filed a 2014 Minnesota fiduciary income tax return taking the position that it was a “resident trust,” paid the tax under protest and included a statement that the statutory definition of a “resident trust” was unconstitutional. Each trust then filed an amended return excluding any gain on the sale on the basis that the stock was intangible personal property located outside of Minnesota and requested a refund. The Minnesota Department of Revenue denied the refund, and the matter came before the Minnesota Tax Court.

The issue before the Minnesota Tax Court was whether Minnesota’s settlor-based definition of “resident trust” as applied to the trusts was unconstitutional. The trusts challenged the constitutionality of the statute on Due Process and Commerce Clause grounds, although the Tax Court only analyzed the Due Process claim.

The Tax Court presented the issue as whether “for due process purposes, the domicile of the grantor alone is a sufficient connection with Minnesota to justify taxing the Trusts as residents (that is, on a base that includes intangible personal property located outside of Minnesota). We agree with the Trusts, in other words, that the issue is not simply whether the State has personal jurisdiction to tax the Trusts.”

In determining which factors to consider in its Due Process analysis, the Tax Court stated that the “sole factor upon which the Legislature intended to base residency for purposes of the [settlor-based] rule is the domicile of the grantor at the time a trust became irrevocable” and therefore any other “nexus” factors are irrelevant. “Consequently, when analyzing the Trusts’ as-applied challenge to the grantor-domicile rule, we will ask whether the domicile of the grantor – standing alone – is a sufficient connection upon which to justify taxing the Trusts as Minnesota residents.”

The Tax Court concluded “that the domicile of the grantor at the time a trust became irrevocable – standing alone – is not a sufficient basis to justify the resident tax treatment of an inter vivos trust. We have previously ruled that the sole state connection we may consider when evaluating residency under [the grantor-domicile rule] is the domicile

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4 Pennsylvania is the only state in the United States that does not recognize “grantor trusts.”
of the grantor at the time the inter vivos trust became irrevocable. Consequently, we conclude that [the settlor-based rule] as applied to the Trusts for tax year 2014, violates the due process provisions of the Minnesota and the United States constitutions.

On appeal, the Minnesota Supreme Court affirmed the Tax Court’s holding. As an initial matter, however, in analyzing whether Minnesota’s resident trust tax statute violated the Due Process Clause, the Supreme Court concluded that it must “look beyond the statutory definition that identifies who is subject to a tax in order to evaluate the relationship between the income taxed and the benefits provided by the state.” That is, regardless of the definition of resident trust in the statute, if there are sufficient contacts to tax the trust as a resident trust, the tax will be upheld as constitutional as applied to that trust.

The Commissioner of Revenue argued that there were sufficient contacts to tax the trust as a resident trust, including: (i) the settlor was domiciled in Minnesota when the trusts were created and remains domiciled in Minnesota; (ii) the trusts were drafted by a Minnesota attorney and are to be interpreted pursuant to Minnesota law; (iii) until late 2014, the trusts’ governing instruments were kept in Minnesota; (iv) primary beneficiary of one of the trusts was domiciled in Minnesota in the tax year in question (2014); and (v) the trusts’ primary asset and source of income in 2014 was Minnesota S Corporation stock for a company that was incorporated in Minnesota and headquartered in Minnesota.

The trusts countered that for the tax year in question, no trustee was a Minnesota resident, the trusts were not administered in Minnesota, the records of the trusts were not maintained in Minnesota, some of the income was derived from investments outside of Minnesota and three of the four beneficiaries reside outside Minnesota.

The Supreme Court concluded that the “contacts on which the Commissioner relies are either irrelevant or too attenuated to establish that Minnesota’s tax on the Trusts’ income from all sources complies with due process requirements[,]” for several reasons:

1. The grantor’s connections to Minnesota “are not relevant to the relationship between the Trusts’ income that Minnesota seeks to tax and the protection and benefits Minnesota provided to the Trusts’ activities that generated that income. The relevant connections are Minnesota’s connection to the trustee, not the connection to the grantor who established the trust years earlier.” (Emphasis in original.)

2. The use of a Minnesota law firm to draft the documents is irrelevant; nothing in the record established that the law firm represented the trustees “in connection with the activities that led to the income that the State seeks to tax, let alone during the tax year at issue.”

3. The trusts did not own any physical property in Minnesota. Although the trusts owned stock in a Minnesota S corporation (which held physical property in Minnesota), “the intangible property that generated the Trusts’ income was stock in [the corporation] and funds held in investment accounts. These intangible assets were held outside of Minnesota, and thus do not serve as a relevant or legally significant connection with the State.” (Emphasis in original.)

4. Any pre-2014 contacts were not relevant because the tax must satisfy the Due Process clause for the tax year at issue. The Supreme Court also noted that “allowing the State to pick and choose among historical facts unrelated to the tax year at issue is unworkable. This ad hoc approach could...”
force taxpayers to challenge tax liability annually until a court determines that the past contacts have been sufficiently decayed such that they are no longer sufficient to support taxation as a resident. Nor can we see any reasonable means of determining when the decay will be sufficient.”

5. The trustees had “almost no contact with Minnesota during the applicable tax year. All trust administration activities by the trustees occurred in states other than Minnesota.” No trustee travelled to Minnesota for any purposes related to the trusts in that year (and one trustee never travelled to Minnesota during her time as a trustee).

6. The choice of Minnesota law as the governing law for the trusts was also not a sufficient contact. “We will not demand that every party who chooses to look to Minnesota law – not necessarily to invoke the jurisdiction of Minnesota’s courts – must pay resident income tax for the privilege. . . . [U]nlike cases in other states that considered testamentary trusts, the inter vivos trusts at issue here have not been probated in Minnesota’s courts and have no existing relationship to the courts distinct from that of the trustee and trust assets.” (Emphasis in original.)

Thus, the Minnesota Supreme Court concluded that the “State lacks sufficient contacts with the Trusts to support taxation of the Trusts’ entire income as residents consistent with due process. The State cannot fairly ask the Trusts to pay taxes as residents in return for the existence of Minnesota law and the physical storage of trust documents in Minnesota. Attributing all income, regardless of source, to Minnesota for tax purposes would not bear a rational relationship with the limited benefits received by the Trusts from Minnesota during the tax year at issue. We therefore hold that [Minnesota’s resident trust taxation statute] is unconstitutional as applied to the Trusts.”

While the Minnesota Supreme Court’s holding in Fielding is, of course, in no way dispositive of whether Pennsylvania’s definition of resident trust would pass Constitutional muster in Pennsylvania courts, it, and several similar taxpayer-favorable decisions in Pennsylvania and other jurisdictions, may signal a sea-change in how courts approach the constitutionality of settlor-based determinations generally.

The Probate and Trust Law Section is pleased to introduce its new hashtag:

#phillyprobatetrust

Please use the hashtag #phillyprobatetrust when posting on social media about news or events that might be interesting to section members!
PENNSYLVANIA PLAYS COY ABOUT THE INHERITANCE TAX IMPLICATIONS OF PET TRUSTS

Chester County Orphans’ Court Decision in King Estate Does Not Help Clarify Confusion

BY RYAN J. AHRENS, J.D. CANDIDATE, 2019 | VILLANOVA UNIVERSITY SCHOOL OF LAW

Some pets are allowed to lie on the couch, and some are left $100,000.1 Some pets get a few extra treats every so often, and some are so adored they receive their own caretaker, house, and trust fund so that their luxurious lives can continue uninterrupted even after their owner’s death.2 Increasing in popularity and often inspiring amusing news articles, pet trusts allow the owner of a pet to dictate just how he or she wants the pet to be taken care of should the owner die while the pet is still alive.3 We are used to caring for our pets while we are alive, but what happens if Max or Buddy outlives us? While leaving large amounts of money in a trust for a pet may seem (to some) like the obvious choice, adoring pet owners in Pennsylvania may be unaware of how much their unfailing love will cost in taxes.

I. A History of Pet Trusts in the Context of Pennsylvania’s Inheritance Tax

Initially, US courts did not treat pet trusts favorably, holding that a gift to a pet trust failed because the trust violated the rule against perpetuities by having the pet—a non-human—as a measuring life.4 Slowly but surely, however, pet owners’ dogged determination swayed public opinion about the positive effects of pet trusts, and today all fifty states statutorily authorize them.5 Perhaps to avoid being perceived as petulant, Pennsylvania explicitly authorized pet trusts back in 2006, so long as the trust only lasts as long as the pet’s life (or pets’ lives).6

While Pennsylvania’s authorization of pet trusts is clear, what is less clear is how a pet trust is taxed for Pennsylvania inheritance tax purposes, or, more specifically, whether pet trusts are subject to the inheritance tax at all.7 As a general matter, Pennsylvania uses a four-tiered inheritance tax structure, where the rate of the tax depends on the relationship of the beneficiary to the decedent.8 Transfers to spouses and (human) children

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2 See Matter of Abels, 44 Misc. 3d 485, 486 (Surrogate’s Court of N.Y., Westchester Cty. 2014) (leaving residuary estate in trust to fund caretaker’s salary and house upkeep until all the owner’s cats died).

3 See Gerry W. Beyer, Johnathan P. Wilkerson, Max’s Taxes: A Tax-Based Analysis of Pet Trusts, 43 U. RICH. L. REV. 1219, 1219-20 (2009) (describing famous pet trust cases, including one dog that was left $12 million).

4 See Id. at 1221 (describing initial problems surrounding gifts to pets).

5 See Id. at 1123-24 (describing efforts of animal rights groups to have states authorize pet trusts).

6 See 20 PA. CONS. STAT. ANN. § 7738 (West 2006) (“A trust may be created to provide for the care of an animal alive during the settlor’s lifetime.”); Pet Trust Laws, The American Society for the Prevention of Cruelty to Animals (last visited August 10, 2018), https://www.aspca.org/pet-care/pet-planning/pet-trust-laws (stating that all fifty states have some form of pet trust law, with Minnesota being the last state to adopt one in 2016).


PET TRUSTS, CONTINUED

under the age of 21 are taxed at 0%, transfers to direct descendants and lineal heirs are taxed at 4.5%, transfers to siblings are taxed at 12%, and transfers to all "all other persons" are taxed at 15%.9

Section 9111 of Pennsylvania’s inheritance tax statute states that an inheritance tax of 15% will be imposed on the transfer of property “to or for the use of all persons” other than specific beneficiaries exempted from the tax.10 That section continues to list various beneficiaries that are exempt from the inheritance tax, including government entities and most non-profit organizations that exist for religious, charitable, scientific, literary or educational purposes.11 Notably, neither animals nor pet trusts are included in Section 9111’s list of exempt beneficiaries.12

The first case to address whether pet trusts are subject to Pennsylvania inheritance tax was Schrock Estate.13 out of the Orphans’ Court of Westmoreland County in August 2015.14 In that case, a pet trust was established for the decedent’s horses.15 The Pennsylvania Department of Revenue argued that the money put in the pet trust was subject to the 15% inheritance tax because (1) the trust was a “person” for the purposes of the inheritance tax statute, and (2) the trust did not fall into any of the statute’s lower-tiered rates.16 Because the inheritance tax statute does not define “person,” the Department of Revenue relied on Pennsylvania’s Statutory Construction Act, which defines “person,” among other labels, as “business trust . . . estate, [or] trust[.]”17

The decedent’s estate countered, arguing that the trust was not subject to the inheritance tax because an animal is not a “person” and therefore was no “transfer” occurred as is required by the inheritance tax statute.18 In coming to this conclusion, the estate relied on Section 2102 of the statute, which does not include animals as a potential “transferee.”19 Because a complete transfer requires both a transferor and a transferee, and animals are not transferees under the statute, the estate argued that the statute did not apply and therefore no inheritance tax was owed.20

9 See 72 PA. CONS. STAT. ANN. § 9116(a) (West 2000) (emphasis added).
10 See 72 PA. CONS. STAT. ANN. § 9111 (West 2016) (emphasis added).
11 See id.
12 See id.
14 See id. at 199-200 (noting that this question was one of “first impression in this Commonwealth.”).
15 See id. at 200.
16 See id. at 201.
17 See id. (quoting 1 PA. CONS. STAT. ANN. 1991 (West 2016)) (internal quotation marks omitted).
18 See id.
19 See id.
20 See id.
PET TRUSTS, CONTINUED

The Department of Revenue attempted to reinforce its argument by noting that the trust was the transferee, not the horses, but the Orphans’ Court agreed with the estate that the trust was “merely an instrument or conduit for the passage of the assets.”21 The Court also noted that the scheme of the inheritance tax statute (that is, determining what rate of tax is owed) depends on the identity of the recipient.22 In the case of trusts, the statute requires examining who the trust beneficiary is in order to determine the applicable tax rate.23 The court stated that if it accepted the Department of Revenue’s argument that the trust was a “person” within the meaning of the statute, that interpretation would be “contrary to the language of the statute[,]”24

II. Chester County Orphans’ Court Rules that Pet Trusts are Subject Pennsylvania’s 15% Inheritance Tax

Not content to just parrot the decision of the Westmoreland County Orphans’ Court, the Chester County Orphans’ Court decided in May 2018 in King Estate25 that pet trusts are subject to Pennsylvania’s 15% inheritance tax.26 In King Estate, a decedent died and left a pet trust for her horses, dogs, cats, and chickens in the amount of $409,288.86.27 In a similar series of events as in Schrock Estate, the Pennsylvania Department of Revenue assessed an inheritance tax of 15% on the money placed in trust, which came out to $61,393.33 owed in taxes.28 Objecting to the 15% assessment, the decedent’s estate cited Schrock Estate and argued that the pet trust could not be taxed because the trust’s beneficiaries were not human.29 The Department of Revenue argued (just like it did in Schrock Estate) that every transfer from a decedent is subject to the inheritance tax unless the transfer is “specifically excepted” in Section 9111 (like transfers to government entities or non-profits).30 In a very brief analysis, the Chester County Orphans’ Court agreed with the Department of Revenue and found that because pet trusts were not specifically listed as exempt transferees in the inheritance tax statute, the inheritance tax applied.31

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21 See id. at 201-02.
22 See id. at 202.
23 See id.
24 See id.
26 See id. at 145.
27 See id.
28 See id. at 145-46.
29 See id. at 146 (citing Schrock Estate, 6 Fiduc. Rep. 3d 199 (O.C. Westmoreland Cty. 2015)).
30 See id. at 146-47 (quoting 72 PA. CONS. STAT. ANN. § 9111 (West 2016)).
31 See id. at 147.
coming to its conclusion, the court noted that while the Westmoreland County Orphans’ Court came to an entirely different conclusion, the Westmoreland County Orphans’ Court still engaged in a “thoughtful analysis.”

III. The Uncertainty of the Orphans’ Courts’ Decisions

What may seem surprising considering Pennsylvania has a population of almost 13 million people and formally legalized pet trusts over a decade ago, whether or not pet trusts are subject to the state’s inheritance tax is still uncertain. As of today, there are two court cases that address the matter. Unfortunately, these two court cases come from two non-appellate level courts, engage in little in-depth analysis, and arrive at completely different conclusions. While residents in Westmoreland and Chester Counties may have a better idea on how their Orphans’ Court would rule if they challenged an inheritance tax assessment on a pet trust, those in Pennsylvania’s sixty-five other counties are left largely in the dark.

This uncertainty looms large over Pennsylvania. On average, 36.5% of American households own a dog, and 30.4% of households own cats. This means that there are at least 4.7 million pet dogs and 3.9 million pet cats in Pennsylvania. Pet trusts are gaining in popularity, and Pennsylvania has no shortage of cats and dogs (not to mention birds, horses, and other exotic animals). Whether or not decedents’ pet trusts will be subject to a 15% tax is a big—and potentially expensive—uncertainty.

Notably, pet trust distributions were not subject to any federal tax until 1976 for the very same reason that the Orphans’ Court in Schrock Estate found that the Pennsylvania inheritance tax did not apply—the beneficiary receiving the money was not human. After 1976, the IRS changed its rules so it had the power to tax every trust. However, this same type of broad clarification has clearly not happened at the state level. Two authors have noted that “little time has been devoted to the tax ramifications of pet trusts.” While the authors of that article were referring more to the federal tax implications of pet trusts, their point seems to be equally true when applied to the inheritance tax consequences of pet trusts.

Five other states other than Pennsylvania impose an inheritance tax (Iowa, Kentucky, Nebraska, Continued on page 17

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32 See id.


35 See Beyer and Wilkerson, supra note 3 at 1219-20.

36 See Beyer and Wilkerson, supra note 3 at 1226 (citing in re Searight’s Estate, 95 N.E.2d 779, 784 (Ohio Ct. App. 1950)).

37 See id. at 1226-27.

PET TRUSTS, CONTINUED

New Jersey and Maryland). Unfortunately, because very few states impose an inheritance tax and their inheritance tax statutes are as equally unclear as Pennsylvania’s when it comes to defining “person,” there is a shortage of any meaningful out-of-state guidance.

One of the biggest issues in both Schrock Estate and King Estate was that Pennsylvania’s inheritance tax statute did not define “person” to include animals or include a special provision that taxed pet trusts even though the trust’s beneficiaries were non-human. In Schrock Estate, the Orphans’ Court fixated on the identities of the trust’s beneficiaries—the decedent’s horses—when coming to its conclusion. Because the horses were not “persons” under the statute, no inheritance tax applied. Like Pennsylvania, the inheritance tax statutes of Iowa, Kentucky, Nebraska, New Jersey and Maryland do not include any specific pet trust provisions. And while each state applies its own unique rate structure and beneficiary class designations, their definitions of “person” either do not exist in the inheritance tax statute, like Pennsylvania, or do not include animals.

The results of the Schrock Estate and King Estate decisions are starkly different; one case states that no inheritance tax is owed, and the other states that the inheritance tax applies at its highest possible rate. Depending on how much money a decedent believes his or her pet (or pets) needs each year plus the estimated lifespan of the animal(s), this “all or nothing” potential tax liability could significantly alter how much money a decedent directs into his or her pet trust. Pennsylvanians who have to make decisions under this cloud of uncertainty deserve either (1) a higher-level court case that more concretely settles this issue, or (2) direction by the Pennsylvania legislature.

Nevertheless, Pennsylvania pet owners need not think that this inheritance tax uncertainty precludes them from any meaningful pet trust planning. Other tax implications of pet trusts can and should be taken into consideration when including a pet trust in an estate plan. Non-inheritance tax considerations include, but are certainly not limited to, the amount of distributions per year, investment strategies for trust assets, and the timing of the creation of the trust.

For the time being, however, as King Estate and Schrock Estate remain the most comprehensive guidance on this issue, Pennsylvania residents may try to hedge their bets by leaving money to a family member with the hopes (but not the guarantee) that the family member will care for the decedent’s pet(s).

Of course, this plan of action would result in less inheritance tax owed if the family member falls within one of the lower-tiered rates of the statute. But under this “plan B,” what decedents would gain in tax savings, they would lose in the certainty that their pet will be taken care of exactly as they wish—something pet trusts, no matter how extravagant they may seem, would guarantee.

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39 See Scott Drenkard, Does Your State Have an Estate or Inheritance Tax?, Tax Foundation (May 5, 2015), https://taxfoundation.org/does-your-state-have-estate-or-inheritance-tax/.


41 See IOWA CODE ANN. § 450.1 (West 2003) (“‘Person’ includes plural as well as singular, and artificial as well as natural persons.”); N.J. STAT. ANN. § 54.33-1 (West 2018) (not defining “person” or “transferee”); MD. CODE ANN. TAX-GEN. § 7-201 (West 1989) (not defining “person”).

42 See Beyer and Wilkerson, supra note 3 at 1225-40.
MINIMIZING STATE INCOME TAX: THREE PLANNING TECHNIQUES EVALUATED

BY MARY-NOELLE RASI, J.D., LL.M., VICE PRESIDENT, WEALTH PLANNER | THE GLENMEDE TRUST COMPANY, N.A.

I. Introduction

The passage of the Tax Cuts and Jobs Act of 2017 (TCJA) has brought about the most sweeping changes to the Federal tax laws since the Tax Reform Act of 1986. The most significant reduction occurs in the income tax rates applicable to C corporations, for whom the top income tax rate has been reduced from 35% to 21%. This change is permanent.

For individual non-corporate taxpayers, the income tax rates have been reduced, albeit comparatively a much less significant reduction. An individual’s standard deduction has been increased to $12,000 for single taxpayers and $24,000 for married couples filing jointly. The Federal estate tax exemption amount has been doubled to $11,180,000 per taxpayer, or $22,360,000 available for use as between a married couple.1 Of course, the news is not all good. These individual income tax changes are generally set to sunset in 2026. Many itemized deductions previously available to individuals are suspended or limited. Roth conversions completed after December 31, 2017 may not be re-characterized. Most notably, the state and local tax (“SALT”) deduction available to the individual taxpayer is limited to $10,000.2

The individual tax changes reinforce the developing planning trend toward strategizing through a lens focused on the income tax. In many cases, the potential income tax savings of a given course of action will simply outweigh potential transfer tax savings of a contrary course of action. The increased Federal estate tax exemption amount relieves many of our clients of the burdens of Federal estate tax liability and, depending upon state of domicile, asset transfer at death may constitute a transfer tax-free event. For these reasons, income tax strategy, and particularly state income tax strategy, emerges as an area rife with opportunity to generate savings for those individuals for whom Federal estate tax liability ceases to be a concern.

This article seeks to explore three techniques that can reduce state income tax liability and that may, in addition, have the potential to mitigate estate tax liability, and to identify the relative risks and benefits of each.

II. Section 529 Planning

One change brought about by the TCJA having consequential implications for personal income tax at the state level is the inclusion of K-12 religious and private school tuition in the definition of “qualified higher education expenses” for purposes of Section 529 savings accounts.3 Taxpayers are now permitted to withdraw up to $10,000 annually from a 529 plan for payment of K-12 tuition, free of Federal income tax. Though Section 529 accounts were originally intended to provide those who would not otherwise save for higher education expenses with a state tax-incentivized manner in which to do so, they are now utilized to create a number of tax efficiencies at both the state and Federal level.


2 Id.


continued on page 19
Beyond the Federal income tax deferral on earnings inside the 529 account and the Federal income tax exemption for withdrawals made for payment of qualified higher education expenses, there are 34 states allowing both (1) either a tax credit or deduction against the personal state income tax for contributions to 529 plans and (2) an exemption from state income tax on qualified distributions from the 529 plan. Washington, D.C. does, too. The remaining states (of those imposing a personal income tax) allow income tax-free qualified distributions from a 529 plan, but offer no deduction or credit for a contribution.

It takes a number of stars to align, though, in order to avail oneself of all the aforementioned tax breaks. Namely, much depends upon the 529 plan itself. Most states offering a deduction for a contribution to a 529 plan require the contribution be made to an in-state plan. A few, Pennsylvania included, offer a deduction for a contribution to any 529 plan, regardless of where it’s based. New Jersey offers no tax advantage for contributions to 529 plans, and New York allows a deduction for contributions to in-state plans only. All states assessing a personal income tax allow qualified distributions from a 529 plan income tax-free (except for in Alabama, where the plan must be in-state).

The definitional expansion of “qualified higher education expenses” to include private and parochial K-12 education provides the residents of some states an opportunity to augment the state income tax savings derived from utilization of the plan. Instead of making contributions that will accrue in the 529 account for the long term, a contribution can be made and withdrawn to pay for K-12 tuition expenses within a very short period of time. This is, arguably, a state subsidy of private school tuition by enabling the payment thereof with tax deductible dollars.

Imagine the following scenario: In a high net worth family, parents and grandparents might both contribute to a child’s 529 plan up to the annual exclusion amount ($15,000 in 2018). Of the funds contributed (depending upon the plan and the domicile of the taxpayer contributors) some or all may be deductible for state income tax purposes. The bulk of the contributions are left to accrue in the account for use at a later date, and $10,000 is withdrawn that year to pay for private elementary school. In a best case scenario, grandparents can pay the balance of the tuition still outstanding directly to the institution and no one uses Federal estate tax exemption.

Though the foregoing scenario illustrates the benefit of the expanded rule, engaging in such gymnastics is not completely without cost. Some state officials have expressed concern that if many constituents begin to funnel K-12 tuition payments through 529 plans it could ultimately undermine state budgets and reduce support otherwise available for programs such as public education. What is more, some states, New York among them, have done more than express concern. The New York State Department of Taxation and Finance has issued a preliminary statement that withdrawals for the payment of K-12 tuition would not be considered qualified distributions.

For those of us providing advice in this arena, it would behoove us to ensure our

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4 Id.
5 Id.

continued on page 20
MINIMIZING STATE INCOME TAX, CONTINUED

clients are aware the possibility exists that state legislatures will act to amend either their Federal conformity rules or their 529 plan statutes and regulations to expressly preclude this use of 529 funds. If a state acts to specifically exclude K-12 tuition as a qualified higher education expense, so too might the state impose penalties on such a withdrawal or require recapture of state tax benefits accrued on contributions.

III. Incomplete Gift Non-Grantor Trust Planning

Another technique increasing in popularity commensurately with the increases in the Federal estate tax exemption amount is the Incomplete Gift Non-Grantor Trust (“ING” Trust). Although thorough consideration of the ING Trust exceeds the capacity of this discussion, a rough outline of the structure is as follows: A client lives in a high income tax state (or is averse to paying state income tax of any amount) and wishes to defer or eliminate state income tax. Often, the client’s family does not wish to, or can’t afford to, irrevocably part with the assets he or she intends to use to fund the ING Trust. The client creates an irrevocable trust in a state imposing no income tax on trust income, and retains some measure of control over trust assets, often in the form of a limited testamentary power of appointment or the like. It is imperative the client’s retained interest be sufficient to ensure the funding of the ING Trust fails to rise to the level of a completed gift. Because the trust must avoid grantor trust status in order to escape taxation under Section 671 of subchapter J of the Internal Revenue Code), the state must be one in which self-settled spendthrift trusts are statutorily permissible (Delaware, Nevada, Wyoming, etc.—there are currently seventeen). The importance of the choice of state situs cannot be overstated, insomuch as the success of the technique rests on the trust remaining a non-grantor trust at all times during its administration. If the trust is reachable by the client’s creditors, it is grantor under the provisions of Section 677. The client is a permissible distributee of the ING Trust, but only with the approval of an adverse party, usually in the form of a distribution committee comprised of the Trustee, a trust protector and, always, other beneficiaries that are permissible distributees with interests in conflict with the client’s. These adverse interests ensure the ING Trust is not deemed a grantor trust under Section 674. Frequently, an ING Trust is funded with highly appreciated assets that would, if sold by the client, result in realization of gain at the state level. Later (ideally, much later), when the Trustee sells the appreciated asset, no state income tax liability should result, although, of course, Federal tax will be owed at the trust level.

Distributions from the ING Trust to the client/grantor/beneficiary are also intended to escape the imposition of state income tax. As a fully discretionary trust, the ING Trust should provide that fiduciary accounting income not distributed shall be accumulated and added to principal. As indicated, supra, income realized inside the trust itself

10 Id.
11 Id.
MINIMIZING STATE INCOME TAX, CONTINUED

A number of caveats are in order, for as beneficial as successful implementation of an ING Trust may promise to be, there are more than a few pitfalls for the unwary. First, the trust must not be subject to tax in the state in which the client is domiciled. If the client is domiciled in a state treating all trusts created by state residents as "resident trusts" regardless of where such trusts are situs, then the trust will not escape taxation at the state level. Ohio, Pennsylvania, Washington, D.C. and Connecticut fall into this category. Other states have affirmatively legislated to address state income taxation of ING Trust income distributed to creators of ING Trusts who are domiciled in the state, regardless of whether the ING Trust itself is a resident trust. Next, clients and their advisors must take care to construct the ING Trust structure well in advance of an anticipated sale in order to avoid challenge by the Service as a step transaction once an appreciated asset is sold inside the ING Trust. Unfortunately, there is also a distinct lack of favorable precedential authority on the subject upon which a taxpayer can reliably rest his or her case. And, in states in which some exception creditors can reach the trust assets (e.g., for alimony or child support), it’s conceivable the trust may be considered a grantor trust under Section 677.

Again, let us not forget that the ING Trust is not a wealth transfer technique, or at least, not designed to mitigate wealth transfer tax liability. It’s anticipated the assets of the ING Trust are includable in the estate of the grantor based on the incomplete nature of the gift funding the trust. Our clients should be very clear on this pertinent point. Whether the ING Trust operates to expose the members of the distribution committee or Trustees of the ING Trust to the risk of Federal estate tax inclusion and resultant transfer tax liability by virtue of approval or veto power over discretionary distributions to the client/grantor remains unresolved, a series of favorable Private Letter Rulings notwithstanding.

13 Id.
15 Id.
16 Karibjanian and Mensch at 1.
17 Id.
18 Cline at 2.
19 Karibjanian and Mensch at 2.

continued on page 22
MINIMIZING STATE INCOME TAX, CONTINUED

All of that being said, when it works, it works. As recently as September 21, 2018 yet another Private Letter Ruling was released in which the Service ruled in favor of the taxpayer on all issues in question: the Trust in question was not a grantor trust, the gift in question was not a completed gift, and distributions from the committee to any beneficiary were neither completed gifts nor caused inclusion in the estates of the committee members. Based on the aforementioned inclusion in the grantor’s estate for Federal estate tax purposes, after the lifetime of the grantor, all assets contained in the ING Trust will receive a step up in cost basis for income tax purposes. And, with TCJA’s introduction of the limitation on state and local tax deductions from the Federal income tax, the state income tax savings resulting from implementation of the ING Trust will be amplified. As advisors, it’s important our clients are aware of both the potential tax savings and the risks inherent in implementation of this cutting edge technique.

IV. Domicile Planning

In an attempt not to throw the baby out with the bath water, let us remember the simplest state income tax planning strategy is to not be a resident of a state imposing a personal income tax. The client who successfully exits a state imposing a personal income tax, in favor of a state that does not, stands to streamline and increase the efficiencies of tax planning opportunities available in the future. Yet, in order to avail oneself of the advantages available to the residents of a given state, one must reside in said state. That is to say, if you’re going to do it, you have to actually do it.

The best counsel we can provide to a client who contemplates taking the plunge is not only to ensure he or she is aware of the parameters of the domicile analysis (e.g., intent to return, actual time spent, nexus, contacts, where the wife is, where the dog is, etc.) but also to understand that at some point someone will likely engage in said analysis…and not in a cursory fashion, either. Statutory residency is not all, and the most powerful indicator of intent in situations where the call is close is testimony: a believable story in which the taxpayer is emotionally invested, and not solely because they stand to lose money. Especially in recent years, testimony can be utilized to tip the scales even when the call is not so close, or in cases where the statutory test may, in fact, weigh in favor of the auditing state. In a similar vein, a client should understand the risks incurred by endeavoring to prove oneself a resident of elsewhere or, perhaps even more perilously, of nowhere.

Earned income may pose an additional hurdle to the best laid plans. A client who successfully extricates herself from an income tax state will still pay tax on the income she earns there, or in any other state imposing a personal income tax. For retirees, the situation becomes a little easier. Certain states will

21 PLR 201838003 (Sept. 21, 2018).
22 Id.
23 Id.
facilitate residency attempts by high-tax states’ refugees with affidavits or declarations of domicile that can be recorded or filed. These receive varying degrees of deference from auditing states.

Domicile may be the best state income tax planning technique there is. It’s certainly the oldest. Even so, it isn’t necessarily a slam dunk. A client who enters into a change of domicile sincerely and adheres to the framework consistently and earnestly can expect positive results. We would do well to impress upon our clients the importance of doing so.

V. Conclusion

After the passage of the Tax Cuts and Jobs Act of 2017, many of our clients have, as far as they can see, no reason to continue to plan. For those for whom the Federal estate tax is, to their minds, a distant and hollow threat, we add value and remain relevant through education and the introduction of possibilities for tax efficiencies. The techniques discussed here and many others present opportunities that our client may not have known exist, and keep us close at hand for the inevitable moment that life or the law changes again, and the planning continues.

This article does not constitute legal, tax or accounting advice and may not be used as such. Neither the author nor Glenmede Trust Company, N.A. is engaged in the active practice of law. This article is intended to be a review of issues or topics of possible interest to Glenmede Trust Company clients and intermediaries, and contains Glenmede’s opinions, which may change without notice after the publication date.

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THE PEPC INVITES THE PHILADELPHIA BAR ASSOCIATION PROBATE AND TRUST LAW SECTION TO JOIN OUR COUNCIL FOR MEMBERSHIP AND PROGRAMMING

**November Luncheon Program**
Tuesday, November 13, 2018
11:45 a.m. - 1:45 p.m.
The Union League
140 S. Broad Street, Philadelphia, PA
Topic: “Now What? A Washington Update from AALU after the 2018 Mid-Term Elections”
Speaker: Chris Morton

**Holiday Party**
Tuesday, December 4, 2018
5:30 – 7:30 p.m.
Union Trust
717 Chestnut Street, Philadelphia, PA

**January Luncheon Program**
Tuesday, January 8, 2019
11:45 a.m. - 1:45 p.m.
The Union League
140 S. Broad Street, Philadelphia, PA
Topic: “Strategic Philanthropy: Lessons Learned and Best Practices for Coherent Family Giving”
Speaker: Bruce DeBoskey

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LEGISLATIVE HAPPENINGS

New IRS Commissioner

On September 12, 2018, Charles “Chuck” P. Rettig was confirmed as the new IRS Commissioner by the Senate. The Senate voted 64 to 33 in his favor and he received both Democratic and Republican support. Commissioner Rettig was nominated by President Trump in February and the Senate Finance Committee advanced his nomination in July. He will take the place of David Kautter, who has been serving as acting IRS Commissioner since John Koskinen’s term ended last November. Commissioner Rettig’s term will expire on November 12, 2022.

Tax Reform 2.0

On September 27 and 28, 2018, the House passed the “Protecting Family and Small Business Tax Cuts Act of 2018”, the “Family Savings Act of 2018” and the “American Innovation Act of 2018” which, collectively, are being referred to as “Tax Reform 2.0.”

The “Protecting Family and Small Business Tax Cuts Act of 2018”, among other things, seeks to make certain provisions from the Tax Cuts and Jobs Act permanent, including:

• Repeal of deductions for personal exemptions;
• Limitations on SALT deductions;
• Deduction for qualified business income;
• Increased alternative minimum tax exemption for individuals.
• Limitation on deduction for qualified residence interest;
• Termination of miscellaneous itemized deductions;
• Repeal of overall limitation on itemized deductions; and
• Increase in estate and gift tax exemption.

The “Family Savings Act of 2018” would, among other things, seek to repeal the maximum age for traditional IRA contributions, provide for portability of lifetime income investments, expand 529 plans, allow penalty-free withdrawals from retirement plans for individuals in case of birth of child or adoptions, exempt individuals with certain account balances from RMD rules, and establish “Universal Savings Accounts” described as “flexible savings tool that families can use at any time that is right for them”.

The “American Innovation Act of 2018” would seek to expand deductions for start-up and organizational expenditures under Section 195 and preserve start-up NOLs and tax credits after ownership change.

Nicole Kaeding, who serves as director of federal projects for the Tax Foundation, a nonpartisan tax-policy research group, commented that “[t]he Senate is not expected to debate these bills.”

GUIDANCE FROM THE IRS

Notice 2018-61 (IRB Bulletin 2018-31) – Regulations will address Section 67(g)’s effect on itemized deductions of trusts and estates.

The IRS intends to issue regulations that will clarify the effect of Section 67(g) on the deductibility of certain expenses incurred by estates and non-grantor trusts described in Section 67 of the Internal Revenue Code. Section 67(g) suspends the deduction for miscellaneous itemized deductions. Estates and non-grantor trusts may rely on the notice for tax years beginning after Dec. 31, 2017.

In Notice 2018-61, the IRS announced that the regulations that it intends to issue will clarify that estates and non-grantor trusts may continue to deduct expenses described in Section 67(e)(1) or are allowable under Code Sec. 642(b), continued on page 26
PRACTICE POINT

CHANGES TO GUARDIANSHIP PRACTICE AND PROCEDURE

BY NEAL G. WILEY, ESQUIRE | ALEXANDER & PELLI, LLC

New Orphans’ Court Rules Chapter XIV Promulgated this Summer, Effective June 2019

After publishing and revising several drafts of the rules governing guardianship procedure, the Pennsylvania Supreme Court officially approved a new version of Chapter XIV of the Orphans’ Court Rules on June 1. The new Chapter will bring sweeping changes to Guardianship practice when it becomes effective on June 1, 2019. I will discuss these changes, and changes to the local rules, in greater detail before the effective date.

Rollout of Guardianship Tracking System (GTS)

As of August 27, 2018, GTS is live in Philadelphia. Once the new system is live statewide, it will allow guardians to view their cases and file their reports in one place, regardless of the county with jurisdiction over the matter, and it will allow courts to review reports and inventories, and see all guardians active in their county in one place.

I spoke with Philadelphia Orphans’ Court staff about the new system to find out what the judges and staff want system users to know, and present the following comments, tips, and tricks courtesy of Judge Carrafiello.

The Guardianship Tracking System (GTS) is Pennsylvania’s first concerted effort to make all guardians accountable for their stewardships. So far, it merely entails self-reporting with no overt penalties or strictures. Further, being a statewide system devised by AOPC, it has not been designed to have regional variations, leaving its largest district user, Philadelphia, with unanswered questions to problems that only exist here.

Already, guardians are complaining that the efforts expended on the new expanded reports and inputting the information into GTS will make serving as a guardian an economic hardship. We, in the Philadelphia Orphans’ Court, have also suffered with the hardship of converting endless streams of data and undertaken extreme efforts to make a system never before used or tested go live and actually become operational without a hitch!

The Supreme Court’s goal was for the statewide GTS system to be live in all 67 Pennsylvania counties by the end of 2018. Furthering this goal,

TAX UPDATE, CONTINUED

Code Sec. 651 or Code Sec. 661 in determining the estate or non-grantor trust’s adjusted gross income for all tax years. Additionally, the regulations will clarify that Section 67(b) and 67(e) deductions are not affected by Section 67(g) as they remain outside the definition of “miscellaneous itemized deductions”.

RECENT CASE

In Harbor Lofts Associates, 151 TC --, No. 3), the Tax Court held that a taxpayer, who was the lessee of two separate buildings, could not take a charitable contribution deduction for granting a conservation easement under Code Sec. 170(f)(3)(B)(iii) and Code Sec. 170(h). The court found that, as the taxpayer did not hold a fee interest in the property and only gave up contractual rights, the deduction was not proper. The court found that a contractual right in a lease was not a qualified real property interest which could give rise to a charitable contribution deduction.

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new guardianship forms, effective July 1, 2018, and new guardianship rules, effective June 1, 2019, were promulgated. Training and implementation of the new system were to occur simultaneously. Thus, the trainers arrived in Philadelphia on Monday August 27, 2018 to provide training to Court users and guardians, as GTS went live for the first county, being the First Judicial District.

Behind the scenes in preparation for August 27, 2018, the team of personnel from the Clerk of Orphans’ Court, Court Administration, and the Orphans’ Court spent many exhaustive hours conforming the guardianship information in the FJD’s system to the mandates and requirements of the GTS system. Migration and integration became common words. This herculean effort required a tremendous amount of resources, including diverting the work efforts of Court personnel and the hiring of part time summer interns. As with any new system, the system is not perfect, and the process and progress is ongoing.

All guardians for incapacitated persons, whether professional or lay guardians, are now required to file their Inventories and Reports in the statewide system using the new forms, which are admittedly longer and more detailed. It is important to keep in mind that GTS is a diagnostic tool to be used for accumulating data for statistical purposes and may be useful in the discovery of latent or patent ambiguities upon review of the information by the Guardianship Investigator.

As we all move forward with GTS, there are a few important things to remember:

• New Guardianship Report and Inventory Forms went into effect on July 1, 2018.

• Mandatory filing in GTS of Guardianship Reports and Inventories for Incapacitated Persons in Philadelphia County went into effect on August 27, 2018.

• The GTS HELP DESK phone number is: 1-877-227-2672 (Monday-Friday 7:30 a.m. -5 p.m.)

• Attorneys may access GTS using their attorney id number.

• Case numbers for GTS are the numeric digits only, e.g. 201801234.

• Philadelphia County requires the electronic filing of Inventories and Annual Reports in either the Orphans’ Court Electronic Filing System or in GTS, as follows:

1) All Inventories for guardians of incapacitated persons, regardless of when due, are required to be filed in GTS. They will no longer be accepted in the FJD’s Orphans’ Court electronic filing system.

2) Annual Reports and Final Reports, including late or overdue reports, that were due on or before 8/26/18 must be filed in the FJD’s Orphans’ Court electronic filing system. If you try to file a report in GTS and it is rejected as being too early, check to see the status and due date listed as “Eligible for Submission” in the Reports Section of the GTS case. If it is too early for GTS, file with the FJD’s Orphans’ Court electronic filing system.

3) Any Annual or Final Reports due on and after 8/27/18 must be filed in GTS.

• Inventories are due ninety (90) days from the date of the Guardian’s appointment.

• Annual Reports are due one year from the anniversary date of the Guardian’s appointment pursuant to 20 Pa. C.S. § 5521(c) (1). While Philadelphia has been generous in accepting late
filings, GTS requires the report be filed annually on the anniversary date of the appointment, and will generate notices for late filings based on that date.

- Final Reports are due within sixty (60) days of the date of death of the incapacitated person, an adjudication of capacity, or modification of existing orders pursuant to 20 Pa. C.S. § 5521(c)(2).

- In Forma Pauperis (IFP) status must be requested by Petition filed with the Orphans’ Court and granted before Inventories or Reports can be filed IFP in GTS.

- If there is a case in GTS which should not be included due to the death of the incapacitated person or the restoration of capacity, please notify the Clerk of Orphans’ Court.

- If there is an active guardianship case which is not in GTS, please notify the Clerk of Orphans’ Court.

- GTS is available on the Unified Judicial System of Pennsylvania Web Portal at: https://ujsportal.pacourts.us/Default.aspx

- The Guardianship Manual is presently being revised and shall integrate the new rules, new forms and GTS in a basic handbook.

- Also see the Notice to the Bar dated August 28, 2018, in the Legal Intelligencer.

Granted, lawyers, guardians, Court personnel and everyone using the GTS system will have to get accustomed to it. But, the truth and reality is that the incapacitated people of Pennsylvania deserve our best efforts, and we must have the patience, perseverance and persistence to not just accept this system as it is, but to see that it reaches its full potential so that it may serve and protect those who can’t do so for themselves.

Facing all of the seemingly insurmountable guardianship issues, including the need for more guardians and for guardianship services, new state rules and forms, drafting proposed local rules, and GTS, we in the Orphans’ Court, at times, feel as if the task is too great and our resources too little. We always know that the Probate and Trust Law Section is there to support our efforts with not merely advice but substantive support. We welcome your future suggestions on all these issues.
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RECENT DEVELOPMENTS IN THE FIDUCIARY EXCEPTION TO THE ATTORNEY-CLIENT PRIVILEGE AND WORK-PRODUCT DOCTRINE

By Jodi C. Murland, Esquire, Professional Responsibility Attorney | Pepper Hamilton LLP


In the October 2016 edition of the Philadelphia Bar Association Probate and Trust Law Section Newsletter, Adam Gusdorff discussed whether Pennsylvania courts have adopted the fiduciary exception to the attorney-client privilege. That exception applies when a trust or estate beneficiary seeks information, including communications with counsel regarding estate or trust administration, that would otherwise be precluded from discovery under traditional attorney-client privilege jurisprudence. The reason behind this exception is essentially that the fiduciary’s duty to administer the trust solely for the benefit of the beneficiaries trumps the attorney-client privilege between the fiduciary and counsel.

As first explained in In re Rosenblum, 328 A.2d 158, 166 (Pa. 1974), the Pennsylvania Supreme Court recognized a beneficiary’s right to access trust records as part of the administration of the trust. That right was fleshed out further in 2002 by the Allegheny Court of Common Pleas in Follansbee v. Getlach and Reed Smith, 22 Fid. Rep. 2d 319, 2002 WL 31425995 (Pa. Com. Pl. 2002). As Mr. Gusdorff previously explained, the Follansbee Court concluded that the attorney-client privilege between a fiduciary and its counsel does not apply to all communications. Specifically, the Court opined that a trustee “cannot withhold from any beneficiary documents regarding the management of the trust, including the opinions of counsel procured by the trustee to guide the trustee in the administration of the trust….” 22 Fid. Rep. at 322-23 (quoting Rosenblum supra).

In adopting the “fiduciary exception” to attorney-client privilege, the Court however cautioned that this exception is not without constraint. Indeed, the Court limited the exception to the facts of before it; that there was no existing litigation or conflict between fiduciary and beneficiary when the documents were generated, and that documents relating to legal advice provided to a trustee, “where its interests differ from the interests of the beneficiaries” is still protected by the attorney-client privilege. Id. at 320. Accordingly, to the extent that Follansbee was pronouncing the existence of the “fiduciary exception,” if there is a conflict between fiduciary and beneficiary, a court could still apply the attorney-client privilege to bar discovery. Also, the Follansbee court intimated that the fiduciary exception may be contingent on who paid for the legal advice; the trustee or the trust. In the later instance, the Court would be more inclined to order production of the documents.

After Follansbee, the Chester County Court of Common Pleas, in In re Thouron Estate (No. 2), No. 1507-0230, 2015 BL 164682 (Pa. Ct. Com. Pl. Oct. 16, 2013) applied the fiduciary exception to attorney-client privilege in the context of estate administration. There, the court ordered the production of all files relating to the administration/management of the estate to the beneficiaries following their objections to the trustee’s accounting, but precluded access to opinions of counsel with respect to the underlying litigation against the executor. The court cautioned, relying on Follansbee, “because of the recognized distinction under the law between communications relating to ‘administration’ and those relating to the ‘defensive’ interests of the trustee and the requirement of ‘good faith’ on the part of the requesting party articulated in Rosenblum, this court finds that a wholesale order granting access to Estate documents is not appropriate.” (citations omitted).

But see In Warriner Trusts, 6 Fid. Rep. 3d 223, 225 (O.C. Susq. 2016), continued on page 31
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(directing the corporate trustee bank to produce the opinions of its in-house counsel, rejecting the notion that there was threatened litigation, and ultimately denying the bank’s motion for reconsideration, based on the reasoning of Follansbee).

Most recently, in In re Estate of McAleer, __ A.3d __, 2018 Pa. Super. 227, 2018 WL 376456 (Pa. Super. August 9, 2018), the appellate court has weighed in on the fiduciary exception to attorney-client privilege and work-product. There, the trustee, who also was a named beneficiary, filed an interlocutory appeal of the court’s order compelling the production of its unredacted billing invoices to the beneficiaries.

In the underlying dispute, the trustee hired two firms to assist in the management of the trust, as well as a firm to assist in challenging the objections to the administration. The beneficiaries objected to the accountings, arguing that the trustee and attorney’s fees were unreasonable and excessive. In connection with their objections, the beneficiaries served a request for production of documents including billing statements for all trustee fees and attorney fees. The trustee did not object to the request but instead produced redacted records. When the beneficiaries filed a motion to compel, counsel did not file a response subsequently appeared at a hearing on the issue during which the trustee argued for the first time that the redacted information was protected by the attorney-client privilege and/or the work-product doctrine. Id. at *7.

The lower court, relying on Follansbee and Rosenblum, directed counsel to produce unredacted records and this appeal followed. Id. at *6. (As in Follansbee, the trial court was the Court of Common Pleas of Allegheny County.)

Although general discovery orders are not final orders and therefore not immediately appealable, the court recognized that discovery orders concerning privileged documents are appealable under the collateral order doctrine. Relying on the facts in the lower court, the Superior Court stated that the trustee did not raise a “colorable” privilege claim until oral argument on the motion to compel. In rejecting the untimely attorney-client privilege argument, the court stated that it was “not a final order, an order certified as final, an interlocutory order appealable as of right, an interlocutory order appealable by permission, or an appealable collateral order.” Id. at *7. As such, it quashed the appeal.

As part of its analysis of whether the order at issue was an appealable collateral order, the Superior Court considered the duty of a trustee to provide information about the trust administration to a beneficiary as set forth in Restatement of Trusts (Third) §82 and Estate of Rosenblum, 328 A.2d 158 (1974). (It did not reference 20 Pa.C.S. §7780.3(a) (relating to a trustee’s duty to respond to requests for information)). Relying on the Restatement and other precedent, the court held “a trustee has a duty to share with Appellees, as beneficiaries, complete information concerning the administration of the Trust” except for “communications with counsel retained for the trustee’s personal protection in the course, or in anticipation, of litigation ....” The court ultimately concluded that, “Appellant neither argued nor presented evidence to establish that the redacted information pertained to communications from counsel retained for Appellant’s personal protection in the course of litigation.” The Superior Court, relying on Follansbee, found it was “constrained to agree with the trial court” that the beneficiaries were entitled to the unredacted billing records. Id. at *6-7.

The Superior Court made the distinction, as in Follansbee and the Restatement, between attorney-fiduciary communications made for purposes of administration and those for purposes of defending litigation, but observed that the record lacked evidence that the communications related to litigation. Id. at *8. The court stated, “Hence, we are left to conclude that the information

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FIDUCIARY EXCEPTION, CONTINUED

contained in the attorney invoices qualifies as communications subject to the general principle entitling a beneficiary to information reasonably necessary to the prevention or redress of a breach of trust or otherwise to the enforcement of the beneficiary’s rights under the trust. For this reason as well, Appellant cannot invoke the protections of the attorney-client privilege.” Id.

As a practical matter, however, the court’s focus on the inapplicability of the attorney client privilege to documents concerning the administration of the trust further bolsters the argument that the fiduciary exception is gaining more traction under Pennsylvania law. It will be interesting to see whether there will be more estate or trust beneficiaries that will be willing to litigate trust administration based on McAleer.

DO YOU HAVE AN ETHICS QUESTION?

WOULD YOU LIKE TO SEE AN ANSWER IN FUTURE ETHICS COLUMNS?

Send your questions and ideas to:

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