Boston Bar Association

Trusts and Estates Section

Mid-Year Review

December 9, 2011

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BBA Tax Law Updates Committee
Mid-Year Updates December 9, 2011

Guidance for 2010 Estates

Notice 2011-66, 2011-35 IRB 179

August 5, 2011

This notice provides instructions to 2010 estates electing out of the estate tax/step-up basis rules and into the modified carry-over basis rules. The Notice also addresses transfer certificates and elections under § 645, in addition to GST allocation instructions (which is discussed below in the section relating to GST Tax Updates).

Background

Under prior law, the estate tax was inapplicable to the estate of any decedent who died in 2010, and such estates were instead subjected to a modified carryover regime under § 1022. On December 17, 2011, the federal estate tax and full step-up in basis was retroactively restored for 2010 decedents, subject to a $5M federal estate tax exemption amount and a 35% maximum federal estate tax rate; however, estates were permitted to elect out of the estate tax provisions and into the zero estate tax/modified carry-over basis rules.

A. Making the § 1022 Election

The executor of an estate of a 2010 decedent may make the § 1022 election by filing Form 8939 no later than November 15, 2011 (this deadline was later automatically extended to January 17, 2012 by Notice 2011-76, discussed below). If no executor has been appointed, any person in possession of property acquired from the decedent may file a Form 8939 for the property he or she possesses.

If both a Form 706 and Form 8939 are filed for the same decedent, the IRS will issue a letter to each filer explaining that the filers must collectively sign and file either a restated Form 706 or Form 8939 on or before 90 days from the date the IRS mails such letter. If no restated Form 706 or Form 8939 is timely filed, the IRS will determine whether a§ 1022 election has been timely made or whether the estate is subject to the estate tax. A taxpayer may not file a Form 706 as well as a conditional Form 8939 that would take effect only if an estate tax audit results in an increase in the gross estate above the applicable exclusion amount.

A Form 8939 filed before the deadline may be amended or revoked, but only on a subsequent Form 8939 filed no later than the deadline. The election is generally irrevocable, with the following exceptions:

- Where the sole purpose is to amend a timely filed Form 8939 to allocate Spousal Property Basis Increase (described in Rev. Proc. 2011-41), and the timely filed Form 8939 was complete except for such allocation, an amended Form 8939 may be filed no later than 90 days after the distribution of the property to which the Spousal Property Basis Increase is allocated.

- Where a Form 8939 was timely filed, an amended Form 8939 may be filed under the automatic six month extension provisions of Treas. Reg. § 301.9100-2.

- An executor may apply for relief to supplement a timely filed Form 8939 under Treas. Reg. § 301.9100-3. Relief will be granted to allocate any Basis Increase (described in Rev. Proc. 2011-41) not previously validly allocated only if: (i) additional property to which Basis Increase could be allocated is discovered after timely filing Form 8939, or (ii) the fair market value of the property reported on a timely filed Form 8939 has been adjusted as a result of an IRS examination or inquiry. No relief will be granted to reduce an allocation of Basis Increase made on a timely filed Form 8939.

- Whether or not a Form 8939 was timely filed, a taxpayer may apply for relief to file under Treas. Reg. § 301.9100-3, but the amount of time that has passed since the decedent's death may constitute a lack of reasonableness or prejudice.

- Persons serving in the United States Armed Forces or affected by a federally declared disaster may have a longer period of time to file Form 8939, pursuant to I.R.C. §§ 7508 and 7508A.

B. Allocating Basis

If the executor or administrator makes a § 1022 election by filing a form 8939, he or she must also allocate Basis Increase on Form 8939. If the IRS receives multiple Forms 8939 for the same decedent that collectively purport to allocate Basis Increase in excess of the Basis Increase available to the estate, the IRS will issue a letter to each filer explaining that the filers must collectively sign and file a restated Form 8939 on or before 90 days from the date the IRS mails such letter. If no restated Form 8939 is timely filed, the IRS will determine how to allocate the available Basis Increase.

C. Reporting Property Acquired from the Decedent

If the executor or administrator makes a § 1022 election, he or she must value and report all property acquired from the decedent (except cash and property constituting the right to receive income in respect of a decedent) on Form 8939, not simply property to which Basis Increase will be allocated. This includes all appreciated property acquired from the decedent, valued as of date of death, that was required to be included on the donor's Form 709, if the property was acquired by the decedent by gift or by transfer for less than adequate and full consideration in money or money's worth during the three years prior to the decedent's death (except certain property acquired by the decedent from his or her spouse). The Form 8939 must be accompanied by supporting documentation as identified in the instructions to the Form 8939.

Where the decedent is a nonresident who is not a citizen of the United States, the executor may report only tangible property situated in the United States acquired from the decedent and any other property acquired from the decedent by a United States person.

Each individual acquiring property subject to a § 1022 election must be provided with a statement, regardless of whether the executor or administrator has allocated basis increase to the property received by that person, within thirty days of filing Form 8939. In accordance with § 6018(c), such statement must include a description of the property, the adjusted basis of the property in the hands of the decedent and its fair market value at the time of the decedent's death, the decedent's holding period for the property, the amount of basis increase allocated to the property (if any), and information regarding whether any gain on the sale of the property would be treated as ordinary income.

Form 8939, which is available on the IRS website, along with instructions, provides that the executor file a separate Schedule A for each recipient, detailing the property distributed to that recipient. The instructions further require taxpayers to use the same Schedule A to provide the required statement of information to reach of the recipients.

Transfer Certificates

Section 6324(a)(1) generally provides that, unless the estate tax is paid in full, a lien is imposed upon the gross estate of a decedent for 10 years from the date of death for any unpaid estate tax liability. A transfer agent holding property registered in the name of a nonresident decedent who is not a citizen of the United States may request that the IRS issue a transfer certificate to permit the transfer of property without liability for the decedent's estate tax. The Notice clarifies that a transfer certificate is not required where a nonresident decedent who is not a citizen of the United States died in 2010 and the decedent's executor makes a § 1022 election. The IRS will not issue transfer certificates in such cases.

Section 645 Election to Treat a Trust as Part of an Estate

An executor or administrator who makes a § 1022 election, and who also wants to make a § 645 election to treat the trust as part of the estate for income tax purposes, may do so, and such trust will be treated as being part of the estate for all taxable years of the estate ending after the decedent's date of death and ending before the second anniversary of the decedent's death.

Revenue Procedure 2011-41, 2011-35 IRB 188
August 5, 2011

This Rev. Proc. purports to provide optional "safe harbor" guidance for estates electing into the modified carryover basis regime under § 1022.

Application of Section 1022

Section 1022 applies to the estate of a decedent who died in 2010 and whose executor makes the § 1022 election as described in Notice 2011-66. If the election is made, property acquired from the decedent is treated as having been transferred by gift, such that the recipient's adjusted basis in the transferred property is the lesser of the decedent's adjusted basis and the fair market value of the property at the decedent's death. The tax basis determined pursuant to such election is applicable to all property acquired from the decedent, regardless of the year in which the property is sold or distributed. Sections 1022(b) and (c) allow for the allocation of additional basis ("Basis Increase") to increase the basis of certain assets that are both acquired from the decedent and are owned by the decedent at death.

Section 1022 does not apply to every type of property transferred from a decedent who died in 2010. For example, it does not apply to cash or to property constituting a right to receive income in respect of a decedent, including annuities subject to income tax under § 72.

Property acquired from the decedent is property acquired by bequest, devise or inheritance or by the decedent's estate from the decedent, including property transferred by the decedent to an inter-vivos qualified revocable trust (as defined under § 645, whether or not a § 645 election is made), or any other trust in which the decedent reserved the right to alter, amend or terminate the trust. It also includes any property over which the decedent had a general power of appointment, property held by the decedent and another person as joint tenants with right of survivorship or as tenants by the entirety, and the surviving spouse's one-half interest in community property, but does not include a decedent's interest in a QTIP trust or similar arrangement. Two examples, which relate to an unsuccessful QPRT that terminates in favor of the decedent's child and an unsuccessful QPRT that terminates in favor of the decedent's estate, are provided in the Rev. Proc. to illustrate the foregoing rules.

Amount of Basis Increase

Basis Increase equals the sum of the General Basis Increase (which is the Aggregate Basis Increase of $1,300,000 plus Carryovers/Unrealized Losses Increase) under § 1022(b) and the Spousal Property Basis Increase of $3,000,000 under § 1022(c). General Basis Increase may be allocated to any property owned by and acquired from the decedent that is not cash or income in respect of a decedent. The Carryovers/Unrealized Losses Increase is the sum of (i) capital loss carryovers that would have been carried from the decedent's last taxable year to a later taxable year but for the decedent's death; (ii) the amount of any net operating loss carryovers that would have been so carried; and (iii) the amount of unrealized losses that would have been allowable if the property acquired from the decedent had been sold at fair market value immediately before the decedent's death. An example is provided to illustrate the calculation of the Basis Increase.

Spousal Property Basis Increase may be allocated to any property owned by and acquired from the decedent that also satisfies the definition of qualified spousal property, which is property that is transferred outright to the surviving spouse or is QTIP property, whether or not held in trust and whether or not a QTIP election is ever made. Spousal Property Basis Increase may be allocated to property that is sold prior to its distribution only to the extent that the executor (i) certifies on the Form 8939 that the net proceeds from such sale will be distributed to or for the benefit of the surviving spouse, and (ii) attaches to Form 8939 each document providing a bequest or devise to the surviving spouse or QTIP trust. The certification is reflected on the Form 8939 as a "check-the-box" item on Schedule A. Spousal Property Basis Increase may also be allocated to property held in a testamentary charitable remainder trust if the surviving spouse is the sole non-charitable beneficiary and the trust would have qualified for the marital deduction under § 2056(b)(8) if a § 1022 election had not been made. Three examples are provided to illustrate the calculation of the Spousal Property Basis Increase.

In the case of a nonresident, non-U.S. citizen decedent, the Aggregate Basis Increase is limited to $60,000 and cannot be increased by the Carryovers/Unrealized Losses Increase. The Spousal Property Basis Increase remains the same.

General Rules for Allocating Basis Increase

Basis Increase may be allocated on a property-by-property basis, provided that the resulting adjusted basis in each such property does not exceed the fair market value of the property at the decedent's death. The General Basis Increase may be allocated to property that is disposed of or distributed during the estate administration process prior to the filing of the Form 8939. Basis Increase may be allocated to some or all of the decedent's interest in a particular property at death, including to a life estate or remainder interest; however, if the decedent's property is divided as a result of the decedent's death into different interests that are not fractional, Basis Increase cannot be allocated separately to the various interests in the property created by reason of the decedent's death.

Fair market value for purposes of reporting under the § 1022 election is determined in the same manner as for purposes of the estate tax under § 2031, including the appraisal requirements thereunder.

Generally, the decedent's interest in community property is treated as owned by and acquired from the decedent if at least one-half of the whole of the community interest in such property is treated as owned by, and acquired from, the decedent. In such case, the surviving spouse's one-half interest is treated as owned by and acquired from the decedent for purposes of § 1022. In other words, the surviving spouse's basis in his or her one-half interest in community property will be the lesser of the surviving spouse's adjusted basis of that interest in such community property or the fair market value of hat interest on the decedent's date of death. In addition, Basis Increase may be allocated to the surviving spouse's one-half interest in such community property. Two examples are provided to illustrate the community property rules.

Interaction of Section 1022 with Other Tax Provisions

If a § 1022 election is made, the recipient's holding period of property subject to such election shall include the period during which the decedent held the property, whether or not any Basis Increase is allocated to such property. The tax character of property acquired from a decedent is determined the same way as the holding period; therefore, the tax character is the same as it would have been in the hands of the decedent. The tax character of the property, however, may be affected by a subsequent change in the recipient's use of the property.

Any passive activity losses that would have been sustained on a hypothetical sale of the property immediately prior to the decedent's death may be included in the section 165 losses in the General Basis Increase.

The surviving spouse's interest in certain community property is deemed to have been owned by and acquired from the decedent, and therefore 100% of that community property is deemed to have been transferred by gift for purposes of § 1022, and 100% of any passive activity losses allocable to the interests are to be added to determine the decedent's and the spouse's adjusted basis in that community property and to determine the amount of unrealized section 165 losses to be included in the General Basis Increase.

If an executor uses appreciated property to satisfy a pecuniary bequest, the estate must recognize gain to the extent that the fair market value of the distributed property at the time of the distribution exceeds the fair market value on the date of the decedent's death. The basis of the property in the hands of the recipient would be the sum of the basis of the property immediately before the distribution and the amount of gain recognized by the estate. This safe harbor applies to distributions of appreciated trust property made in satisfaction of trust provisions that are the equivalent of a pecuniary bequest under qualified revocable trusts defined in § 645(b)(1) and any trust that would have been included in the decedent's estate for federal estate tax purposes under §§ 2036, 2037 or 2038 had a § 1022 election not been made.

A transfer of property subject to a § 1022 election by a United States person to a foreign estate, a foreign trust or a nonresident alien is treated as a sale or exchange of such property, requiring the transferor to recognize gain in the amount of any excess of the fair market value of the property at the time of the transfer over the transferor's adjusted basis. The amount of gain recognized thereby may be reduced or even eliminated if sufficient Basis Increase is allocated to such property.

A testamentary charitable remainder trust that otherwise qualifies as a charitable remainder trust under § 664, but fails to meet the requirement that a deduction is allowable under § 2055 solely because a § 1022 election is made, thereby making § 2055 inapplicable to the decedent's estate, will nevertheless qualify as a charitable remainder trust under § 664.

Notice 2011-76, 2011-40 IRB 479

September 13, 2011

This Notice provides the following filing extensions and penalty relief for estates of 2010 decedents:

- The due date for filing Form 706 and paying the estate tax for estates of decedents who died on or after January 1, 2010 and on or before December 16, 2010 is automatically extended to March 19, 2012 if a Form 4768 was filed by September 19, 2011, without any need to substantiate the reason for requesting a payment extension.

- The due date for filing Form 706 and paying estate tax for estates of decedents who died after December 16, 2010 and before January 1, 2011 is automatically extended for six months if a Form 4768 was filed by the original due date for filing the Form 706, again without any need to substantiate the reason for requesting a payment extension.

- All late filing and late payment penalties are waived for 2010 estates that timely file a Form 4768 and Form 706 (including the automatic extension).

- The due date for filing Form 8939 is automatically extended from November 15, 2011 to January 17, 2012 without need for any filing.

- If a § 1022 election is timely made, the decedent's available GST exemption may be allocated (or an election may be made) on an attached Schedule R or R-1, and the allocation or election will be considered timely and effective as of the decedent's date of death pursuant to § 2632. Automatic allocation rules apply in cases where a Form 8939 is filed without either such Schedule.

- If a recipient of a 2010 decedent's property disposed of the property in 2010 and timely filed an income tax return, but the IRS later increases the recipient's tax liability by reason of a § 1022 election, the recipient's reasonable cause and good faith will be presumed, and the IRS will not impose failure to pay penalties or the additional 20% penalty under § 6662(a).

DOR Directive 11-XX
October 11, 2011

The Massachusetts Department of Revenue issued a two-part draft Directive for practitioner comment addressing whether assets passing from Massachusetts decedents who died in 2010 and later years will receive a full step-up in basis for Massachusetts income tax purposes.

Directive 1 provides that property of decedents dying in 2010 will not receive a step-up in basis, but rather will receive modified carryover basis in accordance with the provisions of § 1022 of the Internal Revenue Code, whether or not a § 1022 election is made for federal purposes. There is no requirement to file any form with the Department of Revenue to set forth the allocation of Basis Increase pursuant to § 1022, whether or not Form 8939 is filed for federal purposes.

Directive 2 provides that property of decedents dying in 2011 and later years will receive a full step-up in basis.

The BBA's responses to this Directive, and to the ambiguity of the underlying statute to which the Directive relates, will be discussed by the Public Policy Committee.

Changes to 2010 Form 706

- Executors of estates may elect to apply modified carryover basis treatment. If the election is made, no estate tax is due and Form 706 should not be filed. Form 8939 should be filed instead.
- For decedents dying between January 1, 2010 and December 16, 2010, the due date for filing Form 706 2010 is September 19, 2011.
- For decedents dying after December 16, 2010, the due date for filing an estate tax return is nine months after the date of the decedent’s death
- The applicable exclusion amount is $5,000,000—a credit equivalent of $1,730,800.
- The maximum estate tax rate is 35%.
- The applicable rate for generation-skipping transfers is zero.
- Prior gifts must be calculated at the rate in effect at the decedent’s date of death.
- The ceiling on special-use valuation is $1,000,000.
- The amount used in computing the 2% portion of estate tax payable in installments is $1,340,000.
- Executors must provide documentation of their status.

Guidance for 2011 Estates

Notice 2011-82
Release Date September 29, 2011
Guidance on Electing Portability of Deceased Spousal Unused Exclusion Amount

Background:

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 contained a brand-new provision allowing executors of estates of decedents dying in 2011 and 2012 to elect to allow the decedent's surviving spouse to use the deceased spouse's remaining exclusion amount. Such election is commonly referred to as the "portability election." Notice 2011-82 provides guidance to executors wishing to make or refrain from making the portability election.

Guidance:

1. The executor makes the election by filing a timely and complete 706.

Under §2010(c)(5)(A), in order for a surviving spouse to take advantage of his or her deceased spouse's unused exclusion amount, the executor of the deceased spouse must have computed the deceased spouse's unused exclusion on a timely filed 706. If the return is properly extended, the election may be made within the additional time period. Once made, the election is irrevocable.

Making a portability election indefinitely extends the statute of limitations on the 706. Under §2010(c)(5)(B), the Secretary may examine the return of a predeceased spouse for purposes of determining the deceased spouse's unused exclusion amount, even after the statute of limitations on the deceased spouse's return has run out.

There is no box to check or statement to attach to the return; the filing of a complete and timely Form 706 guarantees the election. Until such time as the Service revises the form to provide a computation of the deceased spousal unused exclusion amount, a timely filed and complete 706 will satisfy this requirement.

2. Executors of even small estates must file a 706 to elect portability.

In order to allow the decedent's surviving spouse to use the decedent's unused exclusion amount, the executor must file a complete return, regardless of the size of the gross estate. The notice acknowledges that most married couples will want to elect portability, and that as a result, the number of estate tax returns filed is likely to increase significantly.

3. Executors may affirmatively choose not to make the election.

There are three ways to elect out of portability: (i) fail to file a timely and complete Form 706; (ii) attach a statement to Form 706 that the estate is not making the election under §2010(c)(5);or (iii) write across the top of the first page of Form 706 "No Election Under Section 2010(c)(5)".

The notice also alerted taxpayers that the Service intends to issue regulations addressing the portability election in greater detail.

The notice did not address several aspects of portability, including: (i) the order in which a surviving spouse uses his or her own exclusion and the remaining exclusion of his or her deceased spouse; (ii) the specific calculation of the deceased spousal unused exclusion amount and the applicable exclusion amount; (iii) the effect of the last predeceasing spouse limitation described in §2010(c)(4)(B); and (iv) the scope of the Service's right to examine the predeceased spouse's 706 notwithstanding the statute of limitations. The Service is seeking comments on these topics.

HR 3467, the "Sensible Estate Tax Act of 2011"
Bill Introduced by Congressman McDermott (D., Wash)
November 17, 2012

In addition to reducing the estate tax exclusion to $1,000,000 (indexed for inflation), reinstating the 55% top tax rate, and imposing restrictions on GRATs, this proposed bill contains two significant taxpayer-friendly provisions: making portability permanent and grandfathering any large taxable gifts made while the current $5,000,000 exclusion is in force.

Instructions to Form 706
For Decedents Dying After December 31, 2010 and before January 1, 2012
(Revised August 2011)

Summary:

The instructions to the 2011 Form 706 provide that the applicable exclusion amount includes the basic exclusion amount ($5,000,000) plus any unused exclusion amount from a predeceased spouse who died after December 31, 2010. If the executor of a predeceased spouse's estate wishes to permit the surviving spouse to use the predeceased spouse's unused exclusion amount, a timely and complete Form 706 is required for the predeceased spouse's estate. If the executor wishes to prohibit the surviving spouse from using the predeceased spouse's unused exclusion amount, the executor should either attach a statement that the estate is not making the election under §2010(c)(5) or write "No Election Under Section 2010(c)(5)" across the top of the first page of the form.

Specific Portability Changes:

Part 2 – Line 9 Maximum Unified Credit (applicable credit amount)

The applicable exclusion amount is the sum of (i) the $5,000,000 basic exclusion amount, and (ii) the deceased spousal unused exclusion amount (in the case of a decedent having a predeceased spouse dying in 2011).

Part 4 – Line 3 Marital Status

If the decedent's prior marriage ended in death, and the predeceased spouse died after December 31, 2010, the executor must indicate on the Explanation line whether the executor of the predeceased spouse's estate made the portability election. If so, then the executor should attach the Form 706 of the predeceased spouse and calculate the deceased spousal unused exclusion amount, which is the lesser of (i) the $5,000,000 basic exclusion amount and (ii) the $5,000,000 basic exclusion amount minus the amount in Line 5, Part 2 of the <u>last predeceased spouse's</u> Form 706.

Part 4 – Line 4 Surviving Spouse's Information

The instructions note that the estate makes the portability election by filing a timely and complete Form 709, and repeats the methods by which the executor may choose not to make the election.

Other Changes to 2011Form 706

- Estates, GST transfers, and lifetime gifts have a rate of 35%.
- The credit for lifetime transfers is reunified with the credit for transfers made at death.
- The applicable exclusion amount now consists of a basic exclusion of $5,000,000 and, in the case of a surviving spouse, the unused exclusion amount of a predeceased spouse.
    - In this case, a Form 706 must be filed for the predeceased spouse's estate even if there is no estate tax due in order to allow the surviving spouse to use the last predeceased spouse's unused exclusion amount.
- If the estate chooses not to allow the surviving spouse to use the deceased spouse's unused exclusion amount, then one of the following must occur:
    - The estate must attach a statement to Form 706 indicating that the estate will not make the election; or
    - Write "No Election Under Section 2010(c)(5)" across the top of the first page of Form 706.
- Prior gifts are calculated at the rate in effect at the decedent's date of death.
- The ceiling on special use valuation is $1,020,000.
- The amount used in computing the 2% portion of estate tax payable in installments is $1,360,000.
- Executors must provide documentation of their status.

Estate and Gift Tax Updates

Estate of Ellen D. Foster

TC Memo 2011-95 (4/28/2011)

Tax Court denies discounts for hazards of litigation

Facts:

In 1991, Mr. Foster and the company he founded, Foster & Gallagher, Inc. ("F&G") entered into a stock restriction agreement which required F&G to purchase all of Mr. Foster and Mrs. Foster's stock upon their deaths and to maintain life insurance on their joint lives in order to fund the purchase. In 1995, Mr. Foster and others decided to sell the majority of their stock to an ESOP. F&G borrowed $70 million, unsecured, to finance the ESOP's purchase.

Mr. Foster transferred the sale proceeds and his remaining stock to his revocable trust. When Mr. Foster died, three marital trusts were established for Mrs. Foster, of which Northern Trust Company and Mrs. Foster were co-trustees. After F&G began to have financial troubles, Northern Trust waived the restrictions under the stock restriction agreement and allowed F&G to borrow against the cash value of the life insurance. Mrs. Foster also loaned about $7 million to F&G, which she borrowed herself from Northern Trust. These transactions were completed with the counsel of a law firm, which had also previously advised both Mr. and Mrs. Foster and F&G with respect to the stock restriction agreement. Ultimately, F&G filed for bankruptcy, the life insurance lapsed and the beneficiaries of the ESOP sued Mrs. Foster as executor of Mr. Foster's estate and Mrs. Foster and Northern Trust as trustees of the marital trusts and sought to impose a constructive trust on the marital trusts. The District Court held against the ESOP plaintiffs, who appealed. Mrs. Foster died while the appeal was pending but her co-executors entered into a settlement agreement and the Court of Appeals eventually affirmed the District Court's judgment.

During the process of estate administration, the executors of Mrs. Foster's estate began to investigate claims against the law firm which provided counsel, alleging malpractice and breach of fiduciary duty, and Northern Trust, alleging breach of fiduciary duty. When preparing the federal estate tax return, the executors of Mrs. Foster's estate discounted the value of each marital trust for liability related to the ESOP lawsuit. More than two and half years after filing the estate tax return, the co-executors eventually settled with the law firm for $850,000 and Northern Trust for $17 million. The executors had not included these potential claims against the law firm or Northern Trust as assets on the estate tax return.

Procedure:

The IRS issued a notice of deficiency, disallowing the discounts applied to the value of the property held by the marital trusts, and later increased the deficiency to assert tax attributable to the value of the estate's claims against the law firm and Northern Trust.

Issue:

Whether the estate was entitled to deduct the value of the ESOP claim as a claim against the estate under IRC Section 2053 and whether the value of the property held in the marital trusts could be discounted due to the hazards of litigation.

Discussion and Decision:

The Tax Court held that no discount was applicable to the marital trusts for the hazards of litigation, explaining that due to the timing of the ESOP plaintiffs' appeal and the applicable rules of civil procedure, the assets of the marital trusts were not subject to the plaintiffs' claims of constructive trust at the time of decedent's death. Therefore, the litigation would not have affected the rights of a potential purchaser of the marital trust assets and did not justify a discount.

In addition, the Tax Court held that the estate was not entitled to deduct the value of the ESOP claim as a claim against the estate under IRC Section 2053 because the value of the claim was not ascertainable with reasonable certainty on the valuation date. The Treasury Regulations under IRC Section 2053 allow deductions even if the exact amount of the claim is not known as long as it is ascertainable with reasonable certainty and will be paid. The estate retained two experts—one who determined that a 29% discount was applicable and another who determined that a 12.9%-17.2% discount was appropriate to account for the ESOP lawsuit. The Tax Court held that the range of discount suggested by the experts evidenced a lack of reasonable certainty.

The estate also argued that a discount should apply to the value of the Marital Trust assets because of the freeze imposed by Northern Trust as a result of the litigation. However, the Tax Court noted that the freeze imposed restrictions with respect to Mrs. Foster but not the underlying trust assets. And, since the freeze was only loosely imposed and trust assets were in fact sold for undiscounted prices, no hypothetical buyer would have been affected by the freeze.

The IRS valued the estate's claim against the law firm and Northern Trust at $20.6 million in its deficiency notice. However, at trial, the IRS failed to provide any evidence of the value of the claims against the law firm. After concluding that the experts' opinions on the value of the claim against Northern Trust were not objective or reliable, the Tax Court came to its own conclusion that the value of the claim as of the date of death was $930,000. Lastly, the Tax Court did allow the estate to deduct its actual litigation expenses under IRC 2053.

Estate of Chancellor

TC Memo 2011-172 (7/14/2011)

Introduction:

This case involves a Federal estate tax deficiency of $716,013, determined by the inclusion of the value of trust assets over which the IRS argued decedent had a general power of appointment. A general power of appointment is defined in IRC §2041(b) as "a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate." The value of property over which a taxpayer has a general power of appointment is includible in his estate upon his death. However, if the power is limited by an ascertainable standard, often known as a "HEMS standard," for health, education, maintenance or support, then the power is deemed a "special power of appointment" and does not cause estate inclusion.

Facts:

The decedent died on November 16, 2004. She predeceased her husband, who died in 1989. Upon her husband's death, the decedent received the bulk of his estate outright. Additionally, a testamentary trust was created by his will, which established a trust under which she was both a beneficiary with her husband's children and grandchildren and a co-trustee with a banking institution. The terms of the trust allotted income to the beneficiaries and access to principal limited by an ascertainable standard. Her husband's will also included a clause directing the trust to be funded with an amount that could pass free of federal transfer tax, which would have been $600,000 in 1989. The decedent never received any corpus from the trust.

Analysis:

At issue is IRC §2041 and whether the testamentary trust granted the decedent a general power of appointment, such that its value should have been includible in her estate. In order to reach the final answer in this case, it is necessary to analyze the specific terms of the trust. The contentious language is emphasized as follows: "for the necessary maintenance, education, health care, sustenance, **welfare or other appropriate expenditures needed by [the beneficiaries] of this trust taking into consideration the standard of living to which they are accustomed and any income available to them from other sources**."

In order to avoid estate tax inclusion, a power of appointment must be limited by an ascertainable standard related to the beneficiary's health, education, support or maintenance. The IRS argued that the limitation was too broad and did not narrowly apply to the appropriate standard, but was more akin to a "standard of living" limitation for "comfort or happiness," which causes inclusion. However, it has been determined that access to principal to support a beneficiary's manner of living limited by an ascertainable HEMS standard prevents Federal estate tax inclusion.[1]

[1] Estate of Strauss v. Commissioner, T.C. Memo. 1995-248.

According to Blodget v. Delaney, the Massachusetts Supreme Court relates the term "welfare" with the language of the HEMS standard, to mean "the physical comfort and state of physical well-being to which the life beneficiary had become accustomed."[2] Accordingly, the language at issue can rightfully be construed to refer to the limiting standard necessary to avoid estate tax inclusion.

Here, ejusdem generis saved the day. This very restrictive cannon of construction applies "when a general word or phrase follows a list of specifics, [such that] the general word or phrase will be interpreted to include only items of the same type as those listed."[3]Ejusdem generis is rarely ever applicable, but applies when the intention of the testator is ambiguous. The IRS argued that the intent of the testator was clear and his purpose was to go beyond the exception of IRS §2041(b)(1)(A). Additionally, the IRS argued that the statement "or other appropriate expenditures" was in the exclusive "or" form, such that it was disjunctive from the listed purposes limited by necessary maintenance, education, health care or sustenance. However, the court determined that the IRS had it wrong. Ejusdem generis allows the word "or" to be inclusive and construed to mean "and" in appropriate circumstances, such as the current case.

Conclusion:

The court determined that the language limiting the decedent's access to principal was in fact in accordance with the exception for IRC § 2041(b)(1)(A) and not a general power of appointment. Therefore, the gross estate did not include the value of the trust.

[2] 201 F.2d 589, 594 (1st Cir. 1953).
[3] Black's Law Dictionary, ejusdem generis.

Estate of Olivo

TC Memo 2011-163 (7/11/2011)

Introduction:

This case involves a Federal estate tax deficiency of $348,852.05 and a penalty of $13,309.29 for substantial estate tax valuation understatement. The deficiency is comprised of three deductions the defendant, Mr. Olivo, claimed on the Federal estate tax return of the decedent.

Facts:

Mr. Olivo was one of four children of the decedent. A licensed attorney with an LL.M. in Taxation, he left the practice of law to care for his ailing parents from 1994 to 2003. Both of his parents suffered from serious illnesses and Mr. Olivo devoted his time to being their care-taker. His father died in 1995 and thereafter he took sole responsibility to care for his mother, who was nearly paralyzed in both her legs. His mother died intestate on April 26, 2003 and he fought with his siblings until he was eventually named administrator. Due to his mother's fragile condition, Mr. Olivo spent his days helping his mother with even the bare essential living tasks, such as bathing, using the bathroom, moving, eating and cleaning.

Before long, Mr. Olivo's siblings were concerned with his well-being, since he was spending all of his time caring for his mother and ultimately ignoring his own health needs. His siblings discussed this issue with the decedent. Mr. Olivo argued that this conversation led his mother to offer to pay him for his services. He explained that an oral agreement was formed such that Mr. Olivo would receive $400 per day, payable upon the death of the decedent. No other siblings were aware of this arrangement, and it was not reduced to writing in any form.

Analysis:

The issues for consideration are whether the estate was entitled to deductions for the following expenses: (1) services rendered by Mr. Olivo, of which he never received payment; (2) the administrator's commission paid to Mr. Olivo; and (3) accountant's and attorney's fees paid to Mr. Olivo. In this case, Mr. Olivo bears the burden of introducing credible evidence to support his claimed deductions.

1. Deduction #1: Expenses for Care-Taking Services Rendered by Mr. Olivo

The only evidence proffered was determined to be self-serving, improbable and uncorroborated testimony by Mr. Olivo himself. As an attorney, it is expected that Mr. Olivo would have known better than to rely on an oral agreement with his mother, especially knowing the surrounding circumstances with the family tension. He argued that he was distracted by his mother's condition and was not "thinking like a lawyer." However, the court pointed out that he was capable of drafting durable powers of attorney for both of his parents and naming himself the attorney-in-fact, at such a time when he was not thinking lawyerly, which obviously contradicts his argument.

After failing to provide adequate evidence for his first argument, Mr. Olivo argued that he was entitled to the reasonable value of services rendered under the doctrine of quantum meruit. In order to be successful in this claim, Mr. Olivo must have had a reasonable expectation of payment. The four elements of quantum meruit require the plaintiff to establish: "(1) the performance of services in good faith, (2) the acceptance of the services by the person to whom they are rendered, (3) an expectation of compensation therefor, and (4) the reasonable value of the services."[4] In this case, the court acknowledged that Mr. Olivo expended extraordinary service to his mother in her care, but the quasi-contractual recovery of quantum meruit was avoided because of the presumption that services rendered to a family member are gratuitous, which exists to favor reciprocal acts of kindness and good will amongst family members. In order to overcome this presumption, Mr. Olivo "must affirmatively show [by a preponderance of the evidence] either than an express contract for remuneration existed or that the circumstances under which the services were rendered were such as exhibit a reasonable and proper expectation that there would be compensation."[5] Since Mr. Olivo was not able to show that he provided the care in more than a voluntary and gratuitous nature and since he was not actually compensated for the services rendered, the court held that the estate was not entitled to the above-claimed deduction.

2. Deduction #2: Administrator's Commission

According to Treas. Reg. 2.2053-3(b)(1), for decedents who died before October 20, 2009, a deduction is allowed for an administrator's commission upon the fulfillment of three requirements:

(1) The district director is reasonably satisfied that the commissions claimed will be paid;
(2) The amount claimed as a deduction is within the amount allowable by the laws of the jurisdiction in which the estate is being administered; and
(3) It is in accordance with the usually accepted practice in the jurisdiction to allow such an amount in estates of similar size and character.[6]

Here, the IRS argued that the deduction was not permissible because Mr. Olivo did not receive probate court approval. However, the court held that judicial approval was not necessary. Additionally, the statutory formula allows the following fees based on the amount of the estate:

(1) 5% on the first $200,000 of the estate;
(2) 3.5% on the excess over $200,000 up to $1 million; and
(3) 2% on the excess over $1 million.

Here, with an estate value of $1,711.163.81, the administrator's fee would be $52,223.28, of which, Mr. Olivo claims to have made a calculation error, only claiming $44,200. So long as the

[4] Estate of Olivo, T.C. Memo. 2011-163 at 14.
[5] *Id.*
[6] *Id.* at 16.

amount is actually paid or is reasonably expected to be paid, the court held that the deduction was allowable.

3. Deduction #3: Accountant's and Attorney's Fees

These fees were actually paid to Mr. Olivo. Under Treas. Reg. 20.2053-3(c)(1), a deduction is allowed for reasonable accountant's and attorney's fees that are actually paid or if the district director is reasonably satisfied that the fees will be paid. Reasonableness of fees is determined by the size and character of the estate and laws in place. Mr. Olivo received $55,400, of which he categorized all as legal fees, and a deduction for $55,000 was claimed. Under New Jersey law, an administrator who is also an attorney is entitled to reasonable legal fees based on "the size and complexity of the estate; the degree of legal skill required to complete that work; whether the estate was involved in any litigation and the outcome of that litigation; and any other factors the court considers important."[7] However, Mr. Olivo failed to keep adequate records for the fees claimed, other than out of pocket expenses for filing fees and appraisals. Where a taxpayer fails to substantiate a deductible amount, the court has the authority to estimate the amount, but need not make an estimate at all if no adequate evidence is provided. Accordingly, the court allowed attorney's fees in the amount of $600, representing the fees for filing and appraisals.

Conclusion:

In summary, this case illustrates some very important points. First, it is crucial to keep detailed records for claimed estate tax deductions. Second, with family relationships, any oral contracts formed should be reduced to writing. Lastly, and notably, attorneys are held to a higher standard than laymen and should never argue that they "were not thinking like a lawyer."

[7] *Estate of Olivo* at 20, (citing *Estate of Simon*, 226 A.2d 639, 641 (N.J. Super. Ct. App. Div. 1967)).

Estate of Louise P. Gallagher v. Commisioner

TC Memo 2011-148

Section 2031 - Closely-held Business Interests

Facts:

Louise Gallagher's estate included 3,970 units of PMG, an LLC electing taxation as an S corporation. This constituted the largest single holding (15%) of the company's outstanding membership units. PMG was a privately-held and family-owned newspaper publishing company. At date of death it published 28 daily newspapers, 13 paid weekly publications, a few specialty publications and it owned and operated a television station. Eight years prior to decedent's death, PMG elected S corporation status and executed a new shareholder agreement restricting the sale of its stock. Three years prior to date of death, the agreement was amended to ensure continued protection of the S corporation status. PMG's assets at date of death were valued at $357,480,762 with liabilities of $283,682,159 for a net asset value (members' equity) of just under $74 million.

Procedure:

The estate included the decedent's interest at a value of $8,800 per unit (total $34.9 million) based on an appraisal by the company's president and chief executive officer. Upon audit, the IRS determined that the fair market value was $49.5 million. Following negotiations and an appeal to the IRS Appeals Office, the estate obtained an independent appraisal report valuing the units at $26.6 million, less than the value on the 706. The IRS issued a deficiency notice confirming its valuation of the units at $49.5 million.

Issue:

What was the value of decedent's 15% interest in PMG on the date of death.

Discussion and Decision:

Judge Halpern reviewed the expert appraisal opinions on behalf of the taxpayer and the IRS in great detail, concluding that the value of the shares on date of death was $32,601,640. Judge Halpern noted that previous decisions required "cogent proof" that the value of stock reported on an estate tax return was erroneous. In Rabenhorst v. Comm., TC Memo 1996-92, the Tax Court had stated "this cogent proof principle is essentially synonymous with the general burden of proof set forth in Rule 142(a).". Thus the court sought to determine whether the taxpayer could show by a preponderance of the evidence that the value on the estate tax return was erroneous.

The IRS's expert determined that the correct fair market value was lower than the value asserted by IRS in its notice of deficiency and this was regarded as a concession by the IRS. The court did not find it necessary to address a shift of the burden of proof from the taxpayer to the Commissioner under Code § 7491(a) since "the parties have provided sufficient evidence for us to find that the value of decedent's units as of the valuation date was $32,601,640." The court first agreed with the IRS expert that June 2004 financial information should be used in valuing the units, even though that information was not publicly available as of the valuation date (July 5, 2004). The taxpayer failed to allege an intervening event between the date of death and the publication of the June financial statements that would cause these to be incorrect.

The court determined that only one of several asserted adjustments to the company's historical financial statements for "non-recurring items" was warranted, namely, the subtraction of a non-recurring gain on divested newspapers four years prior to date of death.

The court next determined that the "guideline company method" was inappropriate for use in this valuation. That method determines fair market value for a privately-held company using market data for similar public companies. Both parties' experts referred to the method in their analyses. The court determined that the four public companies used by the IRS expert were not sufficiently comparable to PMG, among other reasons because the chosen public companies had internet news as an important part of their business models whereas PMG had none. PMG was also more highly leveraged than any of the proposed public company comparables.

The court determined that the discounted cash flow method was the appropriate method to determine PMG's value. Among the factors analyzed by the court was the proper method of "tax affecting the earnings of PMG". The taxpayer's expert tax-affected the company's earnings by assuming a 39% income tax rate in calculating future cash flows and a 40% marginal tax rate in calculating the applicable discount rate. The IRS expert, in contrast, simply disregarded shareholder level taxes in projecting both future cash flows and computing the appropriate discount rate. The court concluded that the IRS expert's method was correct because "the principal benefit enjoyed by S corporation shareholders is the reduction in their total tax burden, a benefit that should be considered when valuing an S corporation. [Taxpayer's expert] has advanced no reason for ignoring such a benefit, and we will not impose an unjustified fictitious corporate tax rate burden on PMG's future earnings".

Following further comparison of the two experts' methodologies, the court proceeded to a discussion of appropriate discounts. Citing <u>Estate of Newhouse v. Comm.</u>, the court noted that it has accepted the inclusion of both a minority discount and a lack of marketability discount in valuing business interests. The minority discount should be applied first, followed by the lack marketability discount, in accordance with prior authorities. The court determined that the appropriate minority discount in this case was 23% and the appropriate lack of marketability discount was 31%, approving the experts' analysis of the restrictive shareholders' agreement.

Estate of Duncan v. Commissioner

TC Memo 2011-255 (10/31/2011)

Deductibility of Interest on Loan Used to Pay Estate Taxes

Facts:

Vincent J. Duncan was a resident of Denver, Colorado when he died. His son, Vincent J. Duncan, Jr. and Northern Trust, NA were appointed co-executors of the Estate.

Vincent's father, Walter Duncan, had divided a successful oil and gas business among Vincent and his brothers, with each receiving his share of the business in trust. Vincent's trust was for the benefit of Vincent, his wife and his descendants during his life (the Walter Trust). At his death, he had the power to appoint the trust's remainder beneficiaries. Vincent Jr. and Northern Trust had been co-trustees of the Walter Trust since September 2005.

As part of his estate plan, Vincent established a revocable trust, the Vincent J. Duncan 2001 Trust (the 2001 Trust). Vincent Jr. and Northern Trust were appointed as co-trustees when Vincent amended the trust in 2004. The trust instrument directed the trustees to pay Vincent's estate's obligations and "death" taxes. After payment of those obligations and taxes, the 2001 Trust divided into six trusts, each named after one of his six children.

After inheriting one-third of Walter's oil and gas business, Vincent started his own oil and gas business which was held through a limited partnership. In December, 2005, Vincent reorganized his oil and gas business. The Walter Trust contributed $2 million and the limited partnership was restructured as an LLC. After the restructuring, the Walter Trust and the 2001 Trust both owned interests in the LLC (the 2001 Trust owned its interest through an S corporation).

Vincent died in January, 2006. He exercised his power of appointment over the Walter Trust in his will and directed the Walter Trust's corpus to be distributed pursuant to the 2001 Trust, which divided the Walter Trust into six trusts, each named after one of Decedent's six children. At his death, Vincent owned several residences, interests in other closely-held businesses and about $2 million in securities. His estate sold the securities and received a distribution of $3.2 million from the S corporation, but did not have enough liquid assets to pay the estimated federal estate tax liability of $11.1 million and other obligations.

Vincent Jr. and Northern Trust decided to borrow from the Walter Trust in order to obtain the funds to pay the estate tax. They decided the 2001 Trust needed a 15-year term on the loan due to the volatility of oil and gas prices.

In October, 2006, Vincent Jr. and Northern Trust, as co-trustees of the Walter Trust, loaned approximately $6.5 million to Vincent Jr. and Northern Trust, as co-trustees of the 2001 Trust. The note was secured and accrued interest at a rate of 6.7% per annum (based on a quote from Northern Trust's banking department for a 15-year market rate loan) which compounded annually. The note was due on October 1, 2021 and prohibited the prepayment of interest and principal.

Procedure:

On the estate tax return, the estate claimed a deduction of over $10 million for the interest owed to the Walter Trust. The IRS issued a deficiency notice determining that the interest expense was not deductible.

Discussion and Decision:

The Tax Court agreed with the estate and held that the interest was deductible. Under IRC Section 2053 and the Treasury Regulations interpreting it, interest is only deductible if it relates to a loan that was contracted bona fide and for adequate and full consideration and if the expense is actually and necessarily incurred in the administration of the estate.

The IRS argued that the loan was not bona fide because the trustees and beneficiaries of both trusts were the same. However, even so, the Court explained that the two trusts were distinct under Illinois law and the loan could not be ignored because that would improperly shift assets to the 2001 Trust. It found that there was a genuine intention to create a debt with a reasonable expectation of payment.

The IRS also argued that the estate could have sold illiquid assets and that the loan terms were unreasonable, concluding that the loan was not actually and reasonable necessary. However, the Court noted that if the estate sold assets to the Walter Trust, its illiquid assets would have been subject to a discount. It also held that the terms were reasonable. Even though the estate ultimately did end up receiving enough cash through its holdings in the businesses to repay the loan, the Court refused to use hindsight to second guess the fiduciaries' decision to borrow from the Walter Trust. The Court also blessed the use of the 6.7% interest rate when the long-term applicable federal rate (AFR) was 5.02%, noting that the AFR would have been inappropriate here because it was based on government obligations which are low risk. The IRS had argued that the interest rate was unreasonable because the trustees did not "negotiate" the rate but the Court held it would be absurd to expect the trustees to try to negotiate between themselves as different fiduciaries.

Revenue Procedure 2011-48
Protective claims under IRC Section 2053

For decedents dying on or after October 20, 2009, the Treasury Regulations limit deductions under IRC Section 2053 for claims against the estate to only those costs that are ascertainable and actually paid by the time the federal estate tax return, Form 706, is filed. For contingent or contested claims against the estate that are not finalized and paid by the time the estate tax return is filed, the estate may file a protective claim to preserve the right to later claim an estate tax refund based on a deduction once the claim is eventually paid. These rules, however, do not apply to unpaid claims against an estate that otherwise are deductible (i.e., ascertainable, not contingent or contested) and do not exceed $500,000.

Revenue Procedure 2011-48 details the procedure for filing an initial protective claim and the later claim for refund. The protective claim must be filed within the statute of limitations period under IRC Section 6511(a) for the filing of a claim for refund, which is 3 years from the time the return was filed or 2 years from the time the tax was paid, whichever is later. Then, once the claim is finalized and paid, the estate may notify the government and make a claim for a refund based on a deduction for the amount actually paid.

For decedents dying after January 1, 2012, the protective claim is made by either filing a Schedule PC as part of the estate's Form 706 (this schedule is expected to be available with the 2012 Form 706) or by filing the Form 843 (which is already available).

For decedents dying after October 19, 2009 and before January 1, 2012, the estate makes a protective claim by filing Form 843.

A separate schedule or form is required for each protective claim. Each claim must be described in sufficient detail so that the IRS has notice of the basis for each claimed deduction. In addition, the reasons and/or contingencies that are delaying actual payment must be described. The notice provides that ancillary expenses (such as attorneys' fees, court costs, appraisal fees and accounting fees) related to the claim against the estate will be deemed to be included in the protective claim for refund.

The notice explains that the IRS will acknowledge receipt in written correspondence but generally not substantively review the initial protective claim. In addition, filing a protective claim should not delay the IRS from reviewing the Form 706 or issuing a closing letter.

Once the claim becomes ascertainable and is paid, the estate must notify the IRS within a reasonable period by filing an updated Form 843 for decedents dying after October 19, 2009 and before January 1, 2012, or a Supplemental Form 706 or an updated Form 843 for decedents dying after January 1, 2012. Separate notifications are required for each claim. The Notice provides that notification within 90 days of when the claim is actually paid will satisfy the reasonable period requirement. For payments that are made in a series, the 90 day period will begin with regard to the entire aggregate amount on the date of the last and final payment. Computation of any other deductions, such as the marital and charitable deductions, should be adjusted on these supplemental forms for the additional deduction under IRC Section 2053 relating to the protective claim. Interestingly, the notice states that "generally, the Service will limit its review of the Form 706 to the deduction under IRC Section 2053 that was the subject of the protective claim."

New Proposed Regulations on Section 2032, Alternate Valuation Date

The IRS published new Treasury Regulations under IRC Code Section 2032 on November 18, 2011. Under IRC Section 2032, property is valued on the date of death unless alternate valuation is elected, in which case, property is valued on the date that is 6 months after the date of death, or for property that is distributed, sold, exchanged or otherwise disposed, the date of such distribution, sale, exchange or disposition.

The proposed regulations expand the listed examples of what constitutes a distribution, sale, exchange or disposition that will qualify for valuation on the date of such distribution. In addition, the proposed regulations describe two exceptions which are not entitled to the valuation-on-distribution-date rule: (1) exchange of an interest in an existing corporation, partnership or entity if the fair market value of the interest exchanged equals the fair market value of the interest received and (2) a distribution or disbursement from a business entity (such as a partnership or corporation) or trust (including retirement savings accounts and plans such as IRA, Roth IRA, 403(b) and 401(k) accounts), if an interest in such entity or trust is includable in the decedent's estate and if the value of the interest immediately before the distribution equals the value of the distributed property on the date of distribution plus the fair market value of the remaining interest immediately after the distribution. If either of these exceptions apply, the interests in the entities or trusts may be valued on the alternate valuation date (the distribution received in the latter case is valued on the date of distribution). However, certain post-death events will not be considered a distribution, sale exchange or other disposition if Congress, by statute, has deemed that event occurred on the date of death. Currently, the only such event is the grant of a qualified conservation easement.

An "aggregation rule" is included for valuing each portion of property that has been disposed of during the six month period. Under this rule, if a portion of an asset is disposed of, the value of that portion is determined by multiplying the total value of the asset as of the date of disposition by the fraction disposed. As a result, no minority interest discount is taken into account.

In addition, the Regulations provide that with regard to property that is includable in a decedent's gross estate because of his right to an annuity, unitrust or other payment under IRC Section 2036, if the alternate valuation date is elected, the value of each payment or distribution during the 6 month alternate valuation period must be valued as of the date of distribution and added to the value of the property generating the annuity, unitrust or payment, valued as of the alternate valuation date. This value is then used to calculate the amount includible in the decedent's gross estate under IRC Section 2036.

The new proposed regulations include examples of the above rules.

Valuation Updates

Estate of Jorgensen v. Commissioner

107 AFTR 2d 2011-2069 (5/4/2011)

FLP Value Included Pursuant to 2036(a)

Facts:

Decedent and her husband, Colonel Jorgensen of the Air Force, developed a portfolio of marketable securities of over $2 million. The couple contributed some of their securities to an FLP, JMA-I, in exchange for limited partnership interests and, in the case of the Colonel, general partnership interests. In addition, even though their descendants didn't make any contributions, their children were listed as general partners and their grandchildren were listed as limited partners.

After the Colonel's death, the Decedent established a second FLP, JMA-II. She contributed her own marketable securities and cash and, as executor of her husband's Estate, the Estate's marketable securities and cash. Again, the children and grandchildren were listed as general partners and limited partners respectively, even though they made no contributions. Although it was apparently intended that the children and grandchildren receive these interests by gift, no gift tax returns were filed to report them (and some were over the annual exclusion amounts).

Both FLPs continued to own only cash and marketable securities, which assets were not actively managed by members of the Jorgensen family. The Decedent withdrew funds and wrote checks on the partnership accounts, including to pay her own income taxes and other personal expenses, even though she had no authority to do so, and the partnership agreements required pro rata distributions. In addition, after the Decedent's death, the funds were also used to pay administration expenses and estate taxes.

Procedure:

The IRS determined a deficiency in the estate tax paid on the Estate, finding that the value of the assets that the Decedent transferred to the two FLPs should have been included in her estate under section 2036(a). The Tax Court ruled in favor of the IRS, finding that the Decedent's inter vivos transfer of assets to the FLPs weren't bona fide sales for adequate and full consideration, and that she had retained the possession or enjoyment of, or the right to the income from, the transferred assets. The Estate appealed to the 9th Circuit, arguing that (1) the benefits retained by the Decedent were de minimis, (2) the Tax Court erred in concluding that there was an implied agreement that the Decedent could access any amount of the transferred assets, and (3) the Tax Court erred in determining that the Decedent's transfer wasn't for full and adequate consideration.

Issues:

1) Were the benefits received by the Decedent de minimis?
2) Did the Tax Court err by concluding that there was an implied agreement that the decedent could have accessed any amount of the transferred assets to the extent that she desired them?
3. Did the Tax Court err in concluding that the Decedent's transfer was not a bona fide sale for adequate and full consideration?

Discussion and Decision:

First, the 9th Circuit found that it was not de minimis that the Decedent personally wrote over $90,000 in checks on the accounts post-transfer, and that the FLPS paid over $200,000 of her personal estate taxes from partnership funds.

Second, the 9th Circuit found that the Tax Court did not clearly err in finding that there was an implied agreement that the Decedent could have accessed any amount, as the actual amount of checks written for the Decedent's benefit does not undermine the finding that she could have accessed more.

Last, the 9th Circuit found that the Tax Court did not err in determining that the Decedent's transfer wasn't for full and adequate consideration. The Court reiterated that transfers to family partnerships must objectively demonstrate a legitimate and significant nontax reason for the transfers. Here, the type of assets transferred (marketable securities) did not require significant or active management, there was some disregard of partnership formalities, and the nontax justifications are weak. Thus, the Tax Court correctly found that the overriding objective purpose appeared to be a mere "recycling of value" into the partnership vehicle to permit discounted gift-giving and reduce the ultimate estate tax owed.

Comments:

Again, this case reiterates that partnership formalities must be followed, and that the partners should not use the funds to pay personal expenses or, after death, estate taxes.

Estate of Liljestrand v. Commissioner

TC Memo 2011-259 (11/2/2011)

FLP Value Included Pursuant to 2036(a)

Facts:

The Decedent's Revocable Trust contributed 13 pieces of real estate to an FLP, which real estate constituted all of his income producing property. His son, Robert, managed the real estate projects. Eventually, the Decedent set up irrevocable trusts for his children and gave partnership interests to the irrevocable trusts; although the gifts were in excess of the annual exclusion, gift tax returns were not filed until death. The FLP did not open a bank account or maintain capital accounts for its first two years. The FLP made disproportionate distributions to the Trust for several years, and also paid many of the Decedent's personal expenses. After the Decedent's death, the FLP paid his estate taxes as well.

Procedure:

The IRS issued a notice of deficiency stating that the FLP should have been included in the Decedent's estate.

Issue:

Were the value of the assets that the Decedent transferred to his FLP included in the value of his gross estate under section 2036(a)?

Discussion and Decision:

All of the FLP assets are included in the Decedent's gross estate under section 2036(a)(1), as the transfer of assets to the FLP was not a bona fide sale for adequate and full consideration and the Decedent retained enjoyment of the transferred assets.

First, in order to determine whether the transfers to the FLP were "bona fide sales," the issue is whether there was a legitimate and significant nontax reason for the FLP. The Estate argued that there were three nontax reasons for the creation of the FLP. First, the Estate argued that the FLP was created to ensure Robert's long-term employment; the Court found that Robert managed the property before the FLP was created, so its creation was not necessary to ensure his employment. Second, the Estate argued that the FLP was created so that the real estate was not subject to partition or division, as allowed by Hawaii law (where the Decedent resided); the Court pointed out that only 3 of the 13 properties were located in Hawaii and would be subject to these statutes, and that the real estate was owned by a trust so that the children could not partition it anyway. Last, the Estate argued that the FLP was created to protect the real estate from potential creditors; the Court found that there was no evidence that the Decedent or any other partner was concerned with creditor claims.

Further, the Court found two reasons that suggested that the transfers were not bona fide. First, the FLP failed to follow partnership formalities, including when it did not open a bank account for two years and used partnership assets to pay the personal expenses of the Decedent. Second, the transfers were not at arm's length and the Decedent "stood on all sides of the transaction" because he made all of the contributions to the FLP.

In addition, the Court found many reasons why the Decedent retained enjoyment of the assets transferred to the FLP. The Court emphasized that the Decedent lacked sufficient funds outside the FLP to maintain his lifestyle, that the FLP assets were used to pay the Decedent's estate taxes, and that disproportionate distributions were made to the Decedent.

Comments:

This case indicates the importance that one not contribute all of his or her income-producing property to an FLP, along with the general importance of following partnership formalities.

Estate of Giustina v. Commissioner

TC Memo 2011-141 (6/22/2011)

FLP Valuation

Facts:

The Decedent and his family owned timber operations, which included growing trees, cutting them down, and selling the logs. At some point, the Decedent and his family created separate business entities, and the Decedent transferred his interests to Giustina Land & Timber Co. (the "Partnership"). At the Decedent's death, his Revocable Trust owned a 41.128% limited partnership interest in the Partnership, which owned about 48,000 acres of timberland. The Decedent's estate tax return reported the value of the LP interest to be $12,678,117.[8]

Procedure:

The IRS issued a notice of deficiency, stating that the value of the LP was $35,710,000[9], and imposed a $2,531,501 accuracy-related penalty.

Issue:

1. What is the proper value of the 41.128% LP interest in the Partnership?
2. Is the Estate liable for the section 6662 accuracy-related penalty?

Discussion and Decision:

In order to determine the value of the LP interest, the Tax Court applied (i) the discounted cash flow (DCF) method and (ii) the asset method. First, the Court recognized that the parties agreed that the value of the timberlands, which constituted the bulk of the Partnership's assets, was $142,974,438, after applying a 40% discount for the delays attendant to selling the Partnership's timberland. The Court then determined that there was a 25% probability that the timberland would be sold and the Partnership liquidated. Thus, the Court assigned a 75% weight to the value under the DCF method and a 25% weight to the value under the asset method.

The DCF method determines the present value of the cash flow from the Partnership if it continued forestry operations. In applying the DCF method, the Court applied a 25% discount for lack of marketability.

The asset method determines the value of the Partnership's assets if they were sold. In applying the asset method, the Court assumed that if the timberland were sold, the Partnership would also

[8] At trial, the Estate contended that the value of the LP interest was $12,995,000 (a greater amount than reported on the return).
[9] At trial, the IRS contended that the value of the LP interest was $33,515,000 (a lesser amount than previously determined).

be liquidated. Thus, it didn't apply discounts for lack of control or marketability to the LP interest under the asset method, and instead found that the 25% weighting and the 40% discount to the timberland value due to the time it would take to sell were sufficient in taking the appropriate discounts into account.

By using the above calculations, the Court determined the value of the LP interest to be $27,454,115. Normally, if there's an underpayment of tax, the penalty imposed is equal to 20% of the portion of the underpayment that's attributable to a substantial estate tax valuation understatement, currently meaning that the value on the estate tax return is 50% or less of the correct value. Here, the Court didn't impose a penalty because there was reasonable cause for the underpayment and the taxpayer acted in good faith, as the Estate hired a lawyer to prepare the estate tax return who hired a professional appraiser to value the LP interest.

Comments:

The Court insisted on assuming a 25% likelihood that the Partnership's assets would be sold, despite the fact that the owners had a long history of retaining the timberland and continuing operations. Query whether this aspect of the Court's reasoning offers ground for appeal.

Estate of Petter v. Commissioner

108 AFTR 2d 2011-5593 (8/4/2011)

Formula Clause

Facts:

The Decedent's uncle was one of the original investors in UPS, and left her his stock when he died in 1982. In 1998, the Decedent created her estate plan and established the Petter Family LLC to own the stock, worth $22.6 million. The Decedent then created two grantor trusts for two of her children, and gifted LLC interests to the trusts. The assignment document provided that the Decedent intended to assign 940 LLC units to each trust. Each trust was to receive a number of units equal in value of the Decedent's remaining gift tax exemption, and then two charities were to receive the difference. The Decedent also sold LLC units to the trusts in exchange for promissory notes, and the sale documents were structured similarly to the assignment documents. The Decedent retained an appraiser to formally value the LLC units, who applied significant lack of control and lack of marketability discounts.

Procedure:

The IRS contended that the value of the LLC interests was higher than reported on the gift tax return. The Decedent argued that the formula clause was valid and that the charities received a greater number of units due to the revaluation. The IRS disallowed the charitable deduction for the additional amounts transferred to the charities by gift, and argued that the units received by the trusts in the sale transaction were worth more than the promissory note paid, causing an extra gift.

The Tax Court agreed with the Decedent's Estate (she died after trial) and held that the formula clause was valid, that the Decedent transferred a fixed amount to the trusts via both a gift and a sale and that the excess amount that passed to the charities was eligible for the charitable deduction.

Issue:

Did the formula clause create a condition precedent for the gift, rendering it ineligible for the charitable gift tax deduction under Regulations 25.2522(c)?

Discussion and Decision:

The formula clause did not create a condition precedent for the gift. The 9th Circuit reasoned that the formula clauses didn't affect whether a transfer would take place, but only the value of the transfer, as after the execution of the assignment and sale documents "the only possible open question was the value of the units transferred, not the transfers themselves."

Comments:

This case strengthens situations in which taxpayers have formula clauses that result in excess gifts to charities. It remains to be seen, however, as to whether formula clauses without charitable beneficiaries will withstand IRS attack.

Estate of Turner v. Commissioner

T.C. Memo. 2011-209

Internal Revenue Code Section 2036(a)

Facts:

Clyde W. Turner, Sr. (Clyde Sr.) died on February 4, 2004, survived by his wife, Jewell. Clyde Sr. and Jewell had four children and many grandchildren. One of their grandchildren, Rory, was known by the family to abuse drugs and had an extensive arrest record, although Jewell had a good relationship with him and often gave him gifts of money. The Turner children themselves were not close.

Clyde Sr. and Jewell relied on two of their grandsons, Marc and Travis, to manage their finances. In April 2002, at Marc and Travis' suggestion, Clyde Sr. and Jewell established Turner & Co. as a Georgia limited liability partnership; however assets were not transferred to the partnership until December 2002. Clyde Sr. and Jewell each contributed approximately $4 Million of assets to the partnership, consisting of 60% bank stock and 40% cash, certificates of deposit, and securities. In return, Clyde Sr. and Jewell each received a 0.5% general partnership interest and a 49.5% limited partnership interest in Turner & Co. Clyde Sr. and Jewell retained more than $2 million of outside assets.

The Turner & Co. partnership agreement was modeled on a standard form used by their attorneys, and listed the purposes for creating the partnership as: "(1) to make a profit, (2) to increase the family's wealth, and (3) to provide a means whereby family members could become more knowledgeable about the management and preservation of the family's assets". The agreement provided that the general partners of Turner & Co., Clyde Sr. and Jewell, would be entitled to a "reasonable management charge" and could amend the agreement at any time.

On December 31, 2002, and again on January 1, 2003, Clyde Sr. and Jewell each gave limited partnership interests in Turner & Co. to their three living children, and to two of their grandchildren, including Rory. Because of their concerns over Rory's drug addiction and legal troubles, Clyde Sr. and Jewell established an irrevocable trust to hold the partnership interests for Rory's benefit.

In April 2004, Clyde Sr. and Jewell, as the general partners of Turner & Co., signed an agreement which provided that they would allocate $500 of their management fee per month to each of Marc and Travis in exchange for their daily management services to Turner & Co. Clyde Sr. determined that the payments should be classified as "gifts of appreciation", therefore Turner & Co. did not treat the payments as deductible expenses, nor did they issue a Form W-2, or Form 1099-MISC to either Marc or Travis.

In addition to their "management fees", Clyde Sr. and Jewell received periodic distributions from the partnership over the years. None of the limited partners received such distributions. The partnership records indicated that Clyde Sr. withdrew money from the partnership to pay income tax derived from partnership income, as well as to pay premiums on life insurance policies held in trust for the benefit of his issue.

Turner & Co. held the partnership assets in several investment accounts, in which only slight changes, such as reinvestment of dividends and the purchase and sale of a handful of select stocks, were recorded. Turner & Co. also engaged in two real estate transactions. In one transaction, Turner & Co. borrowed $171,025 from a local bank to fund the purchase price for the real estate, which Clyde Sr. promptly paid off from his personal checking account, and was reimbursed over time from partnership assets. In the second transaction, Clyde Sr. wrote a personal check to fund the purchase, and was reimbursed from partnership assets the following day.

Clyde Sr. died on February 4, 2004. Clyde Sr.'s estate reported that the general and limited partnership interests had a fair market value of $30,744 and $1,578,240, respectively, as of the date of his death.

Procedure:

On August 4, 2008, the Internal Revenue Service issued a notice of deficiency to the estate, claiming that the value of the assets Clyde Sr. transferred to Turner & Co. should have been included in his gross estate under Section 2036(a). The estate petitioned the Tax Court for relief.

Issue:

Whether the value of the assets transferred by Clyde Sr. to Turner & Co. was includible in Clyde Sr.'s estate under Internal Revenue Code Section 2036(a).

Discussion and Decision:

Section 2036(a) of the Code provides that the value of all property in which the decedent retains the (1) possession or enjoyment of, or the right to income from, the property, or (2) the right to designate the persons who shall possess or enjoy the property, shall be included in the decedent's gross estate. In order to be included in the decedent's gross estate, three conditions must be satisfied: (1) There must be an inter vivos transfer of property, (2) the transfer cannot be a bona fide sale for adequate and full consideration, and (3) the decedent must retain an interest in the property.

1. Inter vivos transfer of property. The court determined there was an inter vivos transfer of property when Clyde Sr. and Jewell transferred assets to Turner & Co.

2. Bona fide sale for adequate and full consideration. The court concluded there was not a bona fide sale to the partnership based on many factors. First, the court found that Clyde Sr. stood on both sides of the transaction with limited to no consultation with Jewell and the proposed limited partners. Second, he comingled personal and partnership funds by making

personal gifts to Marc and Travis from partnership assets and by using partnership assets to pay premiums on his personal life insurance policies. Finally, the court concluded that the period of eight months between the formation of the partnership and the transfer of assets was too long to support the claim that the transfer was a bona fide sale for adequate and full consideration.

A. Legitimate and Significant Nontax Motivations.If the taxpayer can prove there were legitimate and significant nontax reasons for transferring property to a family limited partnership, the transferred property, even without a bona fide sale, will not be included in the decedent's gross estate under Section 2036(a). Purposes such as consolidated asset management, preservation of a unique investment philosophy, facilitation of family disputes, and asset protection can all serve as legitimate and significant nontax reasons for creating a family limited partnership.

Here, the court determined that asset management could not serve as a legitimate nontax purpose because the property transferred to Turner & Co. consisted of mainly passive assets such as marketable securities, fixed income investments, cash, and certificates of deposit, which did not require active management. Turner and Co. did not drastically change the makeup of the portfolio, consolidate the assets, or implement an active or formal investment management strategy after the partnership was formed. The court reasoned that with such a passive portfolio and no unique investment philosophy held by Clyde Sr. which would require supervision by the partnership, asset management could not stand as a significant nontax purpose for creating the partnership.

The court also dismissed claims by the estate that the partnership had been created to promote family harmony. Although the Turner children did not share a close relationship, the court determined that the source of the disharmony between them was personal in nature rather than based on hostility over their parent's finances. The court reasoned that if the Turner children fought amongst themselves over the management of their parent's finances, then the transfer of assets to the partnership could ease that discord and serve as a legitimate and significant nontax reason for creating the partnership. However, in this case, because of the personal nature of the children's animosity, the court concluded that family squabbles were not the motivating factor behind Clyde Sr. and Jewell's transfer of assets to Turner & Co.

Finally, the court determined the partnership was not formed to protect Jewell's assets from Rory or Rory from himself. In this case, there was no evidence that Jewell's gifts to Rory were involuntary, and no evidence that Rory every posed a threat to Jewell which could be removed by transferring assets away from Jewell. The court reasoned that Jewell was in good health physically and mentally, and therefore was in no need of protection from spending her own money as she saw fit. The partnership was also not necessary to protect Rory's inheritance from his own spendthrift habits, as Clyde Sr. and Jewell had already created an irrevocable trust for Rory's benefit. The court therefore concluded that the formation of the partnership could not be based on asset protection.

Based on the above, the court concluded that the transfers did not fit within the legitimate and significant nontax reason exception to the bona fide sale prong of inclusion in the transferor's estate under Section 2036(a). Because the transfers were not bona fide sales and not supported by legitimate and significant nontax reasons, the court concluded that the second prong of Section 2036(a) was satisfied in Clyde Sr. and Jewell's transfer of assets to Turner & Co.

3. Retention by transferor of possession, enjoyment, or right to income. Factors indicating that a decedent retained an interest in assets transferred to a partnership include transferring the majority of one's assets, continuing use of transferred property, comingling of personal and partnership assets, disproportionate distributions to the transferor, and use of partnership funds for personal expenses. In this case, the Turner's received management fees from the partnership although they performed minimal active management and had little need to supplement their income. The Turner's also withdrew money from Turner & Co. at will, when none of the limited partners received any distributions. Clyde Sr. comingled personal and partnership funds by making gifts to his grandsons, paying life insurance premiums on policies held in trust for the benefit of his issue, and purchasing real property on behalf of the partnership with his own funds. The court held these actions showed Clyde Sr.'s transfer of property to Turner & Co. did not limit his enjoyment of said assets after the formation of the partnership in any way.

Conclusion:

The Tax Court concluded that the assets transferred to Turner & Co. should be included in Clyde Sr.'s gross estate under Section 2036(a) because he retained a significant interest in and control over said assets during his lifetime. The bona fide sale exception to the rule did not apply in this case because there were no legitimate and significant non tax reasons for forming the partnership. Finally, the court determined there was an implied agreement among the parties to allow Clyde Sr. to retain possession and enjoyment of the assets held by Turner & Co.

Income Tax Updates

Internal Revenue Bulletin: 2011-42
Release Date October 17, 2011
Withdrawal of Notice of Proposed Rulemaking; Notice of Proposed Rulemaking and Notice of Public Hearing Section 67 Limitations on Estates or Trusts

Background:

Section 67(e)(1) provides that costs paid or incurred in connection with the administration of an estate or trust that would not have been incurred if the property were not held by an estate or trust are fully deductible and not subject to the 2% floor for miscellaneous itemized deductions under §67(a). In 2007, the Service issued proposed regulations providing that costs that are unique to trusts or estates are fully deductible, while costs that could have been incurred by an individual are subject to the 2% floor. In 2008, the U.S. Supreme Court decision of Knight v. Commissioner[10] interpreted the language of §67(e) "would not have been incurred if the property were not held in such trust or estate" to require an analysis of whether an individual holding the same property "customarily" or "commonly" would incur such expenses. If so, then the costs are subject to the 2% floor for miscellaneous itemized deductions under §67(a). The Service subsequently issued several Notices providing interim guidance on the treatment of bundled fiduciary fees (fees paid to a trustee or executor that include fees subject to the 2% floor). Under these Notices, the Service provided that until the final regulations are published, taxpayers may deduct the full amount of any bundled fiduciary fees.

Summary of Proposed Regulations:

A cost incurred by an estate or trust is subject to the 2% floor to the extent it is a miscellaneous itemized deduction under §67(b) and commonly or customarily would be incurred by an individual owning the same property.

Commonly or Customarily Incurred

Costs that are commonly or customarily incurred by individuals include those that do not depend upon the identity of the owner. Examples include costs incurred in defense of a claim and ownership costs (condominium fees, real estate taxes, insurance premiums). Fees paid for tax return preparation, on the other hand, will depend upon the nature of the particular return. For example, fees for the preparation of estate tax returns, fiduciary income tax returns, and a decedent's final income tax return are fully deductible.

Investment Advisory Fees

[10] Michael J. Knight, Trustee of William L. Rudkin Testamentary Trust v. Commissioner, 552 U.S. 181, 128 [101 AFTR 2d 2008-544] S. Ct. 782 (2008).

While investment advisory fees are customarily incurred by individual investors, a trust or estate may have unusual objectives that justify the imposition of a higher fee. The Court in Knight provided that "in such a case, the incremental cost of expert advice beyond what would normally be required for the ordinary taxpayer" is fully deductible. The proposed regulations provide that to the extent that a portion of an investment advisory fee exceeds the fee generally charged to an individual investor, any excess attributable to the unique needs of a trust or estate is fully deductible. The proposed regulations do not provide any examples of such fees, and comments are requested.

Bundled Fees

The proposed regulations require the unbundling of fiduciary commissions, in accordance with Knight. Each cost should be evaluated not by its label, but by the products or services the estate or trust received in return for such cost. If a cost would "customarily" be incurred by an individual investor, then such cost is subject to the 2% floor.

If a bundled fee is not computed on an hourly basis, then only the following costs are subject to the 2% floor: (i) the portion of the fiduciary fee attributable to investment advice; (ii) payments to a third party that would have been subject to the 2% floor if paid directly from the trust or estate; and (iii) payments to the fiduciary or other service provider customarily incurred by individual investors (such as a real estate management fee).

Any Reasonable Method

The Service provides that when unbundling a fiduciary fee, the taxpayer or its return preparer may use "any reasonable method" in allocating costs between those that are subject to the 2% floor and those that are not. However, because the nature of costs paid to third parties or separately assessed by the fiduciary should be readily identifiable, the reasonable method standard does not apply to the determination of such costs.

Effective Date

Following the guidance provided by past Notices, taxpayers are not required to unbundle fiduciary fees for years beginning before the date final regulations are published.

Charitable Updates

Charitable Giving: Final Form 990 RegulationsIssued by IRS
T.D. 9549

September 8, 2011

The Internal Revenue Service and Department of the Treasury issued final regulationsimplementing extensive revisions made in 2008 to Form 990, *Return of Organization Exempt From Income Tax*. The final regulations adopt the temporary and proposed rules issued in September 2008 with some modifications.

These regulations are effective as of September 8, 2011 and apply to tax years starting January 1, 2008. All tax-exempt organizations required to file annual information returns are affected by these regulations.

Elimination of Advance Ruling:

The final regulations eliminate the advance ruling process for new 501(c)(3) organizations. Instead of requesting a determination of public charity or private foundation status in its application for recognition of tax-exempt status, an organization will qualify as a publicly supported organization (and thus a public charity) in its first five years if it can show in its application that it reasonably expects to receive the requisite level of public support during that period.

Public Support Test:

For purposes of the § 509(a) public support test, the regulations lengthen the timeline for computing public charities' level of public support from four prior years to five years: four prior years plus the current tax year. Charities that fail the public support test must be classified as private foundations. The public support test requires a charity to receive more than one-third of its support each tax year from qualifying gifts, grants, contributions or membership fees, or gross receipts from activities that are not an unrelated trade or business.

Under the temporary and proposed regulations, those that fail to meet the test in one tax year could be reclassified as a private foundation as of the first day of the next succeeding tax year if they also continue to fail the test in that succeeding year. The final regulations modify the temporary and proposed regulations to provide that charities that fail to meet the public support test for two consecutive tax years will be treated as a private foundation as of the beginning of the second year of such failure, but only for purposes of § 507 (termination of private foundation status), § 4940 (excise tax on investment income) and § 6033 (organizations required to file). An organization otherwise will be treated as a private foundation as of the first day of the third consecutive tax year.

The regulations require an organization to use the same accounting method for computing its public support that it uses to keep its books and that it uses to report on Form 990.

Threshold for Compensation Reporting:

The final regulations provide new threshold amounts for reporting compensationpaid to officers, related organizations and key employees. The regulations also require that compensation be reported on a calendar-year basis, and modify the rules requiring information reporting upon a substantial contraction.

PLR 201125007

Issued June 24, 2011

Charitable Giving: Post Mortem Reformation of Trust to Create Qualified Charitable Remainder Annuity Trust

Facts:

Decedent's revocable trust provided that upon his death, the trustee shall make a distribution to decedent's niece of all tangible personal property held by the trust. After the such distributions are made, the trust is to pay the health costs of "Family Member" for her lifetime and then distribute the remainder to Foundation, a tax-exempt 501(c)(3) organization.

As initially drafted, the trust did not qualify as a charitable remainder trust within the meaning of § 664. The executor hired a valuation expert to determine the value of Family Member's interest in the trust, and petitioned the court to reform the trust to qualify as a charitable remainder annuity trust. The court agreed to the reformation subject to the estate receiving approval that the reformation qualified under § 2055(e)(3). The executor requested a Private Letter Ruling that the reformation is qualified and that the reformed trust qualifies the estate for a charitable estate tax deduction under § 2055(a).

Discussion and Analysis:

Section 2055(e)(3)(A) provides that an estate tax deduction is allowed with respect to any qualified reformation. A reformation is qualified only if (i) the difference between the actuarial value of the original interest and the actuarial value of the reformed interest does not differ by more than 5%, (ii) the term of the interest remains the same, and (iii) the change is effective as of the date of the decedent's death

The IRS noted that the charitable remainder interest in the trust, before reformation, was a "reformable interest," because it created a charitable remainder interest that was presently ascertainable and severable from the noncharitable interest and that would have been deductible for estate tax purposes, but for the special rules on split-interest trusts. The actuarial value of the charitable remainder interest in the proposed charitable remainder trust would not differ by more than five percent from the actuarial value of those interests provided for prior to reformation. The terms of the proposed charitable remainder trust provided for termination of Family Member's interest at the same time both before and after the reformation. The reformation would be effective as of the date of the decedent's death, and the proceeding was started not later than 90 days after the last date for filing an estate tax return.

Thus, the IRS agreed with the revised valuation and classified the reformation as "qualified" under § 2055(e)(3), which entitled the estate to a charitable deduction under § 2055(a).

PLR 201126007

Issued July 1, 2011

Charitable Giving: Charitable Remainder Trust Approved to Fund Grantor's Annuity Payment through Purchase of Commercial Annuities

Facts:

Taxpayer proposed forming a charitable remainder annuity trust which would include a statement that the trustee has discretion to buy commercial annuity contracts in order to provide for the annuity payment retained by the grantor, as follows:

> "The Trustee shall have the discretion to provide for the annuity payment to Trustor by allocating a portion of the trust assets to purchase an annuity contract which will guarantee to pay to the trust a sum equal to or greater than the Trustor's computed annual annuity payout for the duration of the trust. If the Trustee chooses to provide for the Trustor's annuity payment in this manner, the Trustee may only purchase such contract from an insurer with an A.M. Best Company Insurer Financial Strength Rating of "Superior" (A++, A+) or "Excellent" (A, A). After securing such contract, the Trustee may distribute any amount other than the amount described in Treas. Reg. Section 1.664-2(a)(1) to the charities named in Schedule B any time during the term of the trust. Upon the termination of all noncharitable interests, the Trustee shall distribute all of the principal and income of the trust (other than any amount due to the Annuity Recipient or the estate of the Annuity Recipient) to the charitable organizations, in the percentages designated, as provided in Schedule B."

Taxpayer anticipated that (i) the trustee will actually buy the annuity, (ii) the trustee will possess all incidence of ownership and be entitled to all payments, (iii) the annuity contract will pay the annuity amount annually to the trust, and (iv) the trustee will then pay the annuity amount to the grantor.

Discussion and Analysis:

The IRS stated that the trust was a qualified charitable remainder annuity trust ("CRAT"). Taxpayer represented that the trust would otherwise contain all of the terms in Rev. Proc. 2003-53, 2003-2 C.B. 230. The IRS reviewed the requirements for a CRAT, and concluded summarily that the provision for investing the trust in a commercial annuity would not prevent the trust from qualifying as a CRAT under § 664(d)(1).

Generation-skipping Transfer Tax Updates

Notice 2011-66, 2011-35 IRB 179

August 5, 2011

In addition to setting forth rules for electing out of estate tax for 2010 decedents the notice addresses how a donor may elect out of the automatic allocation of GST exemption to direct skips in 2010 as well as making changes to the due dates for 2010 returns reporting a generation-skipping transfer, allocating GST exemption or opting out of the automatic allocation of GST exemption. Application of the GST to testamentary transfers during 2010 are also covered in the Notice.

Allocating GST Tax to 2010 Transfers

Section 302(c) of the 2010 Act set a special GST tax rate of 0% with respect to generation-skipping transfers made in 2010. Nevertheless, the other provisions of chapter 13 remain intact with respect to transfers made or deemed to have been made in 2010, including the allocation of GST exemption on a timely filed gift or estate tax return.

A. 2010 Estates

The GST tax applies to 2010 estates, whether or not the decedent's executor or administrator makes a § 1022 election out of the estate tax. Although the applicable rate for 2010 transfers is 0%, an executor or administrator who wants a decedent's GST exemption to be allocated differently than it would be allocated under the deemed allocation rules must still file a timely federal estate tax return. An executor or administrator making a § 1022 election on Form 8939 must make such allocation on Schedule R of Form 8939.

If an executor timely files Form 8939 without attaching Schedule R or R-1, the automatic allocation rules will apply.

B. Lifetime Transfers During 2010

If a donor made a lifetime direct skip transfer during 2010 and does not want the IRS to allocate GST exemption to the transfer (because the 2010 applicable rate is 0%), the donor may elect out of the automatic allocation of GST exemption in either of two ways:

- Where the transfer constitutes an inter vivos direct skip not in trust, the donor needs only to timely file a Form 709. Reporting the direct skip on the Form 709 will constitute an election out of automatic allocation of GST exemption to the direct skip not in trust.

- The donor may affirmatively elect out of automatic allocation by timely filing a Form 709 and describing the transfer and the extent to which automatic allocation is not to apply. This is required for all transfers made to GST trusts, regardless of whether the transfer constitutes a direct or an indirect skip.

C. Filing Deadlines

Section 301(d)(2) of the TRA extends the due date for filing a gift or estate tax return reporting a GST transfer (direct skip, taxable distribution or taxable termination) made on or after January 1, 2010 but no later than December 16, 2010, to September 17, 2011. Executors who filed Form 4768 by the due date were entitled an automatic 6-month extension of time to file and pay, Notice 2011-76, 2011-40 I.R.B. 479 (9/13/11). Where a GST transfer is being reported on Form 8939's Schedule R (because the executor or administrator has made a § 1022 election), the form and schedule must be filed no later than January 17, 2012. Notice 2011-76.

The TRA does not extend the due date for returns reporting indirect skips, regardless of when the transfer occurred. It also does not extend the due date for returns electing to treat a trust as a GST trust, or for returns reporting GST transfers that occurred after December 16, 2010.

Final Tax Shelter Disclosure Regulations

I.R.C. Sections 6011, 6111 and 6112 relate to the required disclosure of transactions considered to be tax shelters T.D. 9556, November 10, 2011, promulgated Final Regulations §§ 26.6011-4, 301-6111 and 301.6112-2, which include transactions purporting to reduce or eliminate the GST as transactions requiring disclosure.

Retirement Planning Updates

Private Letter Ruling 201123048, §§ 402(c)(3) and 402(c)(9)-Spousal IRA rollover

Facts:

Deceased husband's pension plan required a 100% distribution of plan assets upon his reaching age 65. Surviving wife stated that her husband had received a check from the plan and begun a rollover into an IRA. The purpose of the rollover was to maintain the funds in a tax-free environment, according to wife's statements.

While the IRA was being set up, husband deposited all of the funds into a joint account with wife. Husband then died prior to the completion of the rollover.

Issue:

Would the IRS waive the sixty day rollover requirement of § 402(c)(3) and allow wife to make a rollover contribution to an IRA in her own name.

Discussion and Decision:

The IRS refused to waive the sixty day requirement despite the provisions of § 402(c) that the period should be waived "… where the failure to waive such a requirement would be against equity or good conscience, including casualty, disaster, or other events beyond the reasonable control of the individual subject to the requirement." In addition, § 402(c)(9) states that distributions to a spouse of an employee after the employee's death may be rolled over as if the spouse were the employee. Rev. Proc. 2003-16 instructs the IRS to consider all facts and relevant circumstances in determining whether to grant a waiver, including, among other factors, inability to complete a rollover due to death; and the use of the amount distributed, for example, in the case of payment by check, whether the check was cashed). The Service stated "… since 'amount 1' was received by [husband] prior to [husband's] death, [wife] is precluded from rolling the funds over into a tax-deferred account in her name under § 402(c)(9) of the Code."

There are two possible distinctions from the numerous favorable rulings allowing post-death rollovers from estates or trusts: (1) the wife should have requested a ruling that the IRA could be finalized as an IRA in the husband's name first; and (2) the fact that husband had deposited the distribution check in a joint account may have been fatal, in that those funds became wife's property upon husband's death. It is possible that a disclaimer of the joint account by wife would have saved the day.

Private Letter Ruling 201125009,

Qualified Disclaimer of Retirement Account Benefits

Facts:

Husband died at a time when he was receiving required minimum distributions from an IRA and several 403(b) retirement accounts. All of the beneficiary designation forms listed wife as primary beneficiary. If wife survived husband and disclaimed her interest in the retirement accounts, a trust created under Article Fourth of husband's will was designated as the contingent beneficiary. Further, Article Third of the will provided that if wife survived husband any retirement accounts naming the trust as beneficiary were to fund a disclaimer trust under Article Fourth. Alternatively, if wife did not survive husband it was provided that any retirement accounts were to pass outright equally to husband's living issue.

Husband had set up automatic deposits of required minimum distributions. These were deposited quarterly by automatic deposit into a joint bank account owned by husband and wife with rights of survivorship.

Following wife's death within a short time, the automatic deposit of required minimum distributions continued. The administratrix of wife's estate sought state court authorization to renounce the wife's entire interest in the IRA and one of the 403(b) accounts. She also sought authorization to renounce the wife's interest in the disclaimer trust under husband's will. The state court granted the relief sought.

Issue:

Whether the automatic deposits of required minimum distributions into the joint bank account followed by the transfer of the entire balance of that account into an account in the name of wife's estate constituted an acceptance of any portion of the husband's retirement accounts.

Discussion and Decision:

The ruling concluded that wife had accepted the required minimum distributions deposited into the joint account and could not disclaim these. However, wife was not precluded from making a qualified disclaimer of the balance of the IRA or 403(b) account.

The result is little surprising given the language of regulation § 25.2518-2(d)(1) to the effect that acceptance is manifested by an affirmative act that is consistent with ownership of the property and that merely taking delivery of an interest or title without more does not constitute acceptance. That regulation also says that a disclaimant is not considered to have accepted property merely because, under applicable local law, title to the property vests immediately in the disclaimant upon the death of the decedent. The latter statement would seem applicable to the joint bank account becoming wife's property upon husband's death. The ruling relied heavily on Rev. Rul. 2005-36, 2005-1 C.B. 1368, holding that a beneficiary's receipt of required minimum distributions from an IRA constituted acceptance of that portion of the corpus of the IRA, plus the income attributable to that amount. The beneficiary's acceptance of those amounts did not preclude the beneficiary from making a qualified disclaimer with respect to all or a portion of the balance of the IRA.

Inflation Adjustments for 2012

In Rev, Proc, 2011-52, 2011-45 IRB (Nov. 7, 2011), the IRS published the inflation adjustments for taxable years beginning in 2012.

- Income tax rate brackets for trusts and estates will be 15% on taxable income not over $2,400, 25% on taxable income over $2,400 but not over $5,600, 28% on taxable income over $5,600 but not over $8,500, 33% on taxable income over $8,500 but not over $11,650, and 35% on taxable income over $11,650;

- The amount used to reduce the net unearned income reported on a child's income tax return that is subject to the "kiddie tax" is $950 (same as in 2009-2011);

- The same $950 figure is used to determine whether a parent may elect to include the child's gross income in the parent's gross income and to calculate the "kiddie tax" (same as in 2009-2011);

- For a child to whom the "kiddie tax" applies, the alternative minimum tax exemption amount may not exceed the sum of (1) the child's earned income for the taxable year, plus (2) $6,950;

- The basic exemption amount for estate and gift tax purposes will be $5,120,000;

- The GST exemption will be $5,120,000;

- An estate electing to use the special use valuation method for qualified farm or business real property may receive an aggregate decrease in the value of qualified real property of not more than $1,040,000;

- The gift tax annual exclusion is $13,000 (same as in 2009-2011);

- The gift tax annual exclusion for gifts to a spouse who is not a U.S. citizen is $139,000;

- The gifts from foreign persons that the recipient may be required to report under Code Sec. 6039F are those is excess of $14,723; and

- The dollar amount used to determine the “2-percent portion” (for purposes of calculating interest under Code Sec. 6601(j) of the estate tax deferred with respect to the value of a closely-held business interest is $1,390,000.

Boston Bar Association Mid-Year In Review
Trusts & Estates Section
December 9, 2011

Massachusetts Legislative Updates

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Prospective Legislation Supported By the Boston Bar Association:

1. Massachusetts Uniform Probate Code (Technical Corrections)
2. Massachusetts Uniform Trust Code
3. Massachusetts Step-Up in Cost Basis
4. Act Regulating the Compensation of Board Members for Public Charities
5. Uniform Anatomical Gift Act
6. Act Regarding the Rights of Adopted Children
7. Payment of Interest on Pecuniary Legacies and Distributions

Other Prospective Legislation:

1. Spousal Elective Share
2. Health Care Proxies
3. Decedent's Email Accounts
4. Amendment to Uniform Durable Power of Attorney Act
5. Third Parties and Trustees

Prospective Legislation Supported By the Boston Bar Association

1. Massachusetts Uniform Probate Code (Technical Corrections): **Bill S.704**.

- Technical corrections (mostly having to do with correcting cross references and creating a better interrelation between other MGL sections and the new MUPC) were endorsed by the Boston Bar Association and introduced to the legislature in the spring of 2009 but have not yet been adopted.

- The Joint Committee on the Judiciary heard testimony from Chief Justice Paula Carey and Mark Leahy from the Mass Bar Association on May 18, 2011 in support of immediate passage of the technical corrections bill.

- Several changes were proposed by a working group that met with members of the bench to streamline guardianship procedures. The proposed changes include: revising the medical certificate to include a question regarding whether the individual's condition is likely to change; allowing nurse practitioners with expertise related to determining capacity to sign a medical certificate; allowing use of a one-page "medical affidavit" in cases where a second medical certificate is necessary; and allowing a guardian to admit a ward to a nursing home stay of less than 60 days without court authority if the placement is based upon a physician's advice, no interested parties object, a notice is filed and mailed to the nursing home, and counsel is appointed to represent the incapacitated person after the filing of the notice.

- On May 31, 2011, the Probate and Family Court released new Guardianship and Conservatorship forms (old forms were effective until June 30, 2011), which are available on the Probate and Family Court's website (http://www.mass.gov/courts/courtsandjudges/courts/probateandfamilycourt/upcforms.html).

2. <u>Massachusetts Uniform Trust Code</u>: **Bills H. 3780 and S. 2034**.

- The Boston Bar Association has endorsed the proposed Massachusetts Uniform Trust Code ("MUTC"), which was developed over many years by the Ad Hoc Massachusetts Uniform Trust Code Committee. The original bill (S.688) was filed initially on May 14, 2010, and was again filed on January 19, 2011, by Senator Cynthia Creem in the Senate, and on January 21, 2011, by Representative Alice Peisch in the House (H.2261).

- On May 18, 2011, the Joint Committee on the Judiciary heard testimony from Representatives of the Boston Bar Association, the Massachusetts Bar Association, the Massachusetts Bankers Association and others regarding the need to adopt the MUTC prior to the enactment (on January 2, 2012) of Article VII of the MUPC.

- On October 24, 2011 the House bill was amended to make the purpose trust provisions of the MUTC similar to the new Pet Trust legislation, thus resulting in new bill H.3756. Thereafter, the bill was amended again to change the preamble to ensure that the bill, if passed, would become effective on January 2, 2012 – the same day the new provisions of the MUPC regarding trusts become effective. This amendment resulted in new bill H.3780.

- On November 2, 2011, the House passed bill H.3780 and referred it to the Senate Ways and Means Committee.

- The Senate is currently in "informal session", which will end in a little under three weeks. For the MUTC to pass, the Senate must vote unanimously in favor of passing the bill to send it to the Governor's desk.

- See attached letter of support for your consideration. If you agree with its contents and the Boston Bar Association position on the pending legislation, we urge you to send it to your state senator.

- Highlights of the proposed MUTC include the following:

- Codifies much of the existing law of trusts (now spread between statutes and court decisions), thereby making the law of trusts more accessible to judges, attorneys and ordinary people (the common law of trusts continues to apply, except as changed by the UTC).
- Provides a set of default rules, which, for the most part, may be altered by the terms of the instrument.
- Makes virtual representation, whereby persons may represent certain other persons if they have identical interests, available for judicial actions and non-judicial settlement agreements, which would speed court decisions.
- Provides statutory support for non-judicial settlement agreements.
- Allows a court to reform or terminate an irrevocable trust with the consent of the settler and all beneficiaries, even where such action would alter substantive provisions or would be inconsistent with a material purpose of the trust.
- Provides the court with considerable leeway to modify an instrument for changed circumstances.
- Gives trustees the power to divide and combine trusts for generation-skipping transfer tax or other purposes.
- Eliminates the distinction between *inter vivos* and testamentary trusts.
- Gives standing to donors of charitable trusts to bring proceedings to enforce the trust's terms.
- Provides limitations on actions against trustees by beneficiaries.
- Allows for the creation of "purpose trusts" (i.e., trusts for specific non-charitable purposes, rather than for specific non-charitable beneficiaries) and pet trusts (see above).
- Allows for directed trusts, in which certain powers may be granted to persons other than the trustees.

3. <u>Massachusetts Step-Up in Cost Basis</u>: **Bill H.2559**.

- This bill would return the step-up in cost basis, for purposes of Massachusetts capital gains tax, for property passing from a decedent who died in 2010 or thereafter.
- Issue with the current law:
    - IRC § 1014 provides for a step-up in cost basis for federal income tax purposes for assets required from a decedent. IRC § 1014(f), introduced by EGTRRA in 2001, replaced the cost basis step-up with carryover basis for decedents who died

in 2010 (although IRC § 1022 allowed certain additional basis allocations). Under the Tax Relief Act of 2010, this alternative modified carryover basis regime only applied for estates electing out of application of estate tax.

- The Massachusetts statute allowing step-up in cost basis is M.G.L. c. 62 § 6F(b)(2)(C): "[I]n the case of property acquired from a decedent within the meaning of section one thousand and fourteen (b) of the Code, the initial basis of such property shall be determined under section one thousand and fourteen of the Code ..."

- When M.G.L. c. 62 § 6F(b)(2)(C) was enacted in 1986, "Code" (defined in M.G.L. c. 62 § 1(c)) referred to "the Internal Revenue Code as amended on January 1, 1985 and in effect for the taxable year." The 1985 Code allowed the full step-up in cost basis for assets passing on death.

- M.G.L. c. 62 § 1(c), the definition of "Code" (which applies to a host of provisions of Chapter 62 pertaining to income tax) has been updated from time to time (to 1988, then to 1998, and then finally to 2005).

    1. Prior to 2005, the cross-references worked as apparently intended: Property passing on death received a full step-up in cost basis for both federal and Massachusetts purposes.

    2. However, the 2005 update crossed wires with the new IRC § 1014(f) introduced by EGTRRA. IRC § 1014(f) (which states that IRC § 1014 shall not apply with respect to decedents dying after December 31, 2009) was set to fall away from the federal code after 2010 under the "sunset provision" of EGTRRA, which is not part of the Internal Revenue Code. The 2005 Massachusetts amendment to the definition of "Code" picked up IRC § 1014(f), but did not pick up the sunset provision. As a result, it would appear that step-up in cost basis fell away in 2010, and (because the definition of "Code" is frozen in 2005), will not return absent Massachusetts corrective legislation.

- For those subject to estate tax, this creates a "double tax" (estate tax and capital gains tax). For all, regardless of net worth, it creates a new and significant tax burden for survivors of those who have died.

- The bill would solve the issue by providing that IRC § 1014(f) will have no effect for Massachusetts purposes (regardless of when the decedent died or what federal elections the decedent's personal representative made).

- A technical argument has been advanced that would read out IRC § 1014(f) from Massachusetts law. For a discussion of the pros and cons of this argument, see Kenneth P. Brier, "A Solution to the Massachusetts Basis Puzzle?" MASSACHUSETTS LAWYERS WEEKLY, May 30, 2011, 39 MLW 1671.

- The Joint Committee on Taxation held hearings on this bill on May 5, 2011, at which time the Boston Bar Association submitted materials to the Committee supporting passage of the bill. Representatives of the Boston Bar Association, the Massachusetts Bar Association, and the Massachusetts Bankers Association met with members of the Committee on June 21, 2011, to further discuss this bill.

- The DOR issued a draft Directive on October 11, 2011, entitled "Massachusetts Basis of Property Acquired from Decedents Who Died in 2010 or Who Die in 2011 or Thereafter", which states that the DOR interprets the law to state that the recipients of property acquired from 2010 decedents receive carryover basis in said property, while recipients of property acquired from decedents dying in 201 and thereafter receive a step-up in basis in said property.

- On November 1, 2011, a group of representatives from the Boston Bar Association Trusts and Estates Section Steering Committee met with Chairman Kaufman and his staff in continued support of the passage of the bill.

- The Boston Bar Association submitted the attached comments to the DOR regarding the directive on November 21, 2011. The comments are consistent with the proposed legislation.

4. <u>Act Regulating the Compensation of Board Members for Public Charities</u>: **Bill H.3516**

- If enacted, this Bill will change MGL c. 12 by adding new Section 8F ½, which will provide as follows:

    - Public charities will be forbidden from compensating any independent officer, director, or trustee for service as such without the prior approval of the Director of Public Charities.

    - The Director may adopt and promulgate guidelines, rules, or regulations to carry out the provisions of the new law, including criteria for granting approval and the time period during which approval shall be effective.

    - The criteria will recognize that service as an independent officer, director, or trustee of a public charity is recognized as a voluntary contribution of time and expertise to benefit the community served by the public charity and that any departure from the voluntary nature of such service requires a clear and convincing showing that compensation is necessary to enable the public charity to attract and retain experienced and competent individuals to serve as independent officers, directors, or trustees.

- Private foundations are considered to be public charities, as they are charitable organizations under Massachusetts law (920 CMR 2.01). As such, the new reporting requirements will affect private foundations in addition to larger public charities.

- The bill is before the Joint Committee on the Judiciary, which heard from the Attorney General, Martha Coakley, at a hearing on September 27, 2011, in support of the bill.

5. <u>Uniform Anatomical Gift Act</u>: **Bill S.2067**

- This bill proposes to amend repeal §§5A – 13 of MGL c. 113, and inserting new MGL c. 113A after c. 113.

- The goal of this bill is to bring Massachusetts anatomical gift laws into the 21^{st} century. The current laws were enacted in 1968. Pursuant to Senator Fargo, the new law would bring Massachusetts in line with federal laws as well as 45 other states, which is important because a majority of organs to Massachusetts donees come from out of state. It will clarify and streamline the process for giving and receiving donations.

- This bill began as S.1098, which was amended to create S.2067 on November 15, 2011. It was passed by the Senate on November 16, 2011, and referred to the House Ways and Means Committee.

6. <u>Act Regarding the Rights of Adopted Children</u>: **Bill H.2262**.

- Chapter 524 of the Acts of 2008 expanded the applicability of the current rule of construction regarding adopted children (i.e., that terms like "child", "grandchild" and "issue" include adopted issue) to trusts that were created prior to August 26, 1958.

- The various bar associations endorsed a bill to delay the implementation of chapter 524 of the Acts of 2008 until July 2010, pending the drafting of a permanent repeal bill.

- A new bill was drafted to repeal permanently chapter 524 of the Acts of 2008, and was introduced in the legislature; however, no vote has yet taken place. Therefore, as of July 2010, Chapter 524 is in effect.

- The version of the bill filed with the legislature would make repeal effective as of April 15, 2009. However, this retroactive repeal will not affect the validity of any action taken or any distribution made or obligated to be made pursuant to Chapter 524 in the interim, and shall not apply to any court proceedings relating to Chapter 524 that were pending on or before July 1, 2009.

- The Joint Committee on the Judiciary heard testimony from representatives of the Boston Bar Association and others regarding the importance of passing this repeal legislation; however, given the lapse of time since the original enactment of the statute, it does not appear likely that the legislature will pass the repeal legislation this session.

7. Payment of Interest on Pecuniary Legacies and Distributions: **Bill S.732**.

- This bill would set the rate of interest for pecuniary legacies under a will or trust to the short term AFR in effect for the month during which interest first becomes payable, rounded to the nearest full percent.

Other Prospective Legislation

1. Spousal Elective Share Bills: **Bills H.2145 and S.1862**.

- One bill ("An Act relative to spousal elective share") was filed on January 20, 2011, by Rep. Garrett Bradley in the House.

- A separate bill ("An Act to improve the spousal elective share") was filed on January 21, 2011, by Senator Creem, in the Senate.

- Both bills (in different ways) would expand upon the set of property against which the elective share is measured (for instance, to include certain lifetime gifts), or against which the elective share may be collected.

- Both bills revise (in different ways) the amount of the elective share, and both establish sliding scales by which the percentage increases depending on how long the decedent and surviving spouse have been married.

- The Senate bill would require express notice of the right to elect and certain disclosures to the surviving spouse.

- Neither bill is supported by the Boston Bar Association.

- The Ad Hoc Committee, comprised of members from the Boston Bar Association, the Massachusetts Bar Association, and the Women's Bar Association, is in the final stages of preparing a draft of a new bill regarding the spousal elective share. Once finalized, it will be submitted to the three bar organizations for review and comment. If supported by the Boston Bar Association, further steps will be taken by the Boston Bar Association to get the bill filed with the House and/or Senate.

2. Health Care Proxies: **Bill S.853**.

- This bill would preclude from service as health care agent those under investigation for, or convicted of, neglect of or bodily injury to the principal, or who are otherwise responsible for the principal's incapacity.

3. Decedent's Email Accounts: **Bill S. 754**.

- This bill would grant a personal representative reasonable access to a decedent's e-mail, absent contrary instructions by the decedent.

4. <u>Amendment to Uniform Durable Power of Attorney Act</u>: **Bill H.2855**.

- This bill would amend M.G.L. c. 201B § 1 to provide that "any person acting under a durable power of attorney shall have an obligation to act in good faith towards the principal who conferred the power."

- It would also add a new §5A, as follows: "A person exercising authority under a durable power of attorney shall be liable for deliberate breach of their fiduciary duty."

5. <u>Third Parties and Trustees</u>: **Bill H.1276**.

- This bill would add a new M.G.L. c. 203 § 14C to protect third persons dealing with trustees, and to provide that third persons generally need not inquire whether the trustee has power to act or is properly exercising a power.

- It would also add a new M.G.L. c. 203 § 14D, providing that a third person generally may act in reliance on a certification of trust in lieu of receiving a copy of the trust to establish the existence of the terms of the trust.

Please check the Trusts and Estate Blog at http://Boston Bar Associationtrustsandestates.blogspot.com/ for updates on legislation initiatives throughout the year.

If you are interested in any of the pending legislative initiatives, you should contact your legislators. For a list of state representatives and senators by town, please see the following website: http://www.mass.gov/legis/city_town.htm.

NEW DEVELOPMENTS IN MASSACHUSETTS CASE LAW

June, 2011 – December, 2011

Presented by: Stacy Mullaney and Kristin Abati, Co-chairs[11]

<u>FEATURED CASES:</u>

1. CHAPTER 93A ACTION and DAMAGES

<u>Sherman v. Shub</u>,
2011 Mass. Super. LEXIS 146 (June 16, 2011)

<u>Facts</u>

Lon Sherman ("Lon") and Marc Sherman ("Marc") (collectively, "Shermans" or "Plaintiffs") each established life insurance trusts in the fall of 1992. The Shermans also purchased two life insurance policies that were to become assets of their respective trusts. The beneficiaries of the life insurance trusts were various family members of the Shermans. The Shermans executed the insurance trusts and purchased the life insurance policies upon the advice of insurance advisers and attorneys.

Later in 2004, as part of a review of their estate planning documents, the Shermans claimed to have discovered defects in the trust instruments and related documents that could result in increased estate tax and gift tax liability in the future.

<u>Procedure</u>

The Shermans filed an action against their insurance advisors and attorneys (the "Defendants") on June 14, 2007 for failure to properly draft insurance trusts and related documents. In a decision dated January 21, 2010, the Superior Court dismissed the Shermans' common-law claims on statute of limitation grounds. The Defendants then brought a motion for summary judgment on the Shermans' sole remaining claim for violation of G. L. c. 93A.

<u>Issue</u>

Are claims for damages based on future increased estate and gift tax liabilities too speculative to support a claim under c. 93A such that Plaintiffs' motion for summary judgment should be allowed?

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[11] We gratefully acknowledge the other members of the Trusts and Estates New Development Committee who assisted in preparing these written materials, namely: Heidi Seely, Jaclyn O'Leary, Jennifer Collins, Caleb Sainsbury, Iris TaymoreSchnitzer, Allison McCarthy, William Moran, Michelle Porter, Kerri Spindler, Lucas Burke, RenatLumpau, Emma Becker and Anne Warren.

Discussion and Decision

The court granted the Defendants' motion for summary judgment.

The Shermans presented an expert who opined that damages may be reasonably calculated by estimating the additional estate taxes for which the Shermans' could be held liable on account of their use of the defective insurance trusts. His calculations were based on the current value of the Shermans' assets assuming no reductions over time, and using tax rates imposed under current laws.

The Defendants countered that estate and gift taxes are subject to calculation <u>only</u> at the time of the respective deaths of the Shermans, and that this calculation is subject to many variables. These variables include: the value of the particular decedent's estate; the nature and amount of any deductions, credits, and exemptions that may be available in each estate; the state or jurisdiction in which each asset is located; the applicable federal and state estate tax laws at the time; the decedent's marital status; and the identity of the beneficiaries of each estate.

The court began its analysis with the following statements about G. L. c. 93A (internal citations omitted): "It is undisputed that damages are an essential element of a cause of action under G. L. c. 93A. Although the plaintiffs correctly point out that they are not required to prove damages with mathematical certainty, there is no recovery unless the 'harm had a reasonably ascertainable monetary value'… It is not uncertainty as to the amount of damages that precludes recovery, but rather the uncertainty as to the existence of damages." Applying these standards, the court held that "any damages to the plaintiffs as a result of the defendants' wrongdoing rest on unknown (and, at least for now, unknowable) factors, and thus are too uncertain and conjectural to grant relief." 2011 Mass. Super. LEXIS 146, *2-3.

To support its conclusion, the court noted that, although there are no Massachusetts cases directly on point regarding recovery for future estate tax liability, cases from other jurisdictions have denied recovery for future estate tax liability precisely because of its speculative nature.

Comment

This case at first appears noteworthy because it is a c. 93A claim against insurance advisors and attorneys. However, it may be more noteworthy as the first case in Massachusetts in which a court has ruled that claims for damages for future estate tax liability rest on unknown factors and thus are too uncertain and conjectural to grant relief.

The timing of this case is also interesting, as the decision was issued in a year following significant changes in federal estate and gift tax laws, including the temporary repeal of the federal estate tax. These events may have influenced the court's ruling, and justify the following statement in the court's decision: "[H]ere, even assuming that there are no changes in the Shermans' personal circumstances and the size of their estates at the time of their future deaths, the court can make no such assumptions with respect to the federal and state tax statutes that may then be in effect." 2011 Mass. Super. LEXIS 146, *2.

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2. QUANTUM MERUIT and UNDUE INFLUENCE

McGeoghean v. McGeoghean
2011 Mass. App. Unpub. LEXIS 936

This decision is issued pursuant to Rule 1:28, is primarily addressed to the parties, and therefore may not fully address the facts of the case or the panel's *decisional rationale. This decision may be cited for its persuasive value but not as binding precedent.*

Facts

The facts of the case are complicated and are described in detail in the Superior Court's decision below, 25 Mass. L. Rep. 528 (Mass. Sup. Ct. 2009), from which this appeal was taken.

The actions arose out of a dispute over the estate of Sarah McGeoghean. Sarah had five children, John, Kevin, Terrence, Timothy, and Maureen. In the case at bar, John and Kevin sued Terrence, Timothy and Maureen, as well as their spouses, seeking, among other things, the rescission of the conveyance of a business property at 144 Smith Place to an LLC of which Timothy was the managing member.

The facts of the case, as far as they are relevant to the appeal, are as follows. In 1992, Sarah promised to leave her interest in 144 Smith Place and her interest in a construction company to John if he continued to pay the bills on the 144 Smith Place property and to pay Sarah a "support salary." In reliance on Sarah's promise, John did so. However, Sarah did not leave the 144 Smith Place property to John. Instead, several months before her death Sarah deeded the property to a nominee trust, of which Timothy was the trustee. Then, less than two weeks before Sarah's death, Timothy, as trustee, deeded the property to the newly formed LLC.

Procedure

The plaintiffs filed an action in Superior Court claiming ownership of 144 Smith Place based on theories of promissory estoppel and unjust enrichment. The trial court found that Sarah's actions were unduly influenced by the defendants and ruled in favor of the plaintiffs. The defendants appealed.

Issue

Was John entitled to quantum meruit damages in compensation for relying on Sarah's promise to give him the 144 Smith Place property, and if so, what was the measure of damages?

Discussion and Decision[12]

The Appeals Court affirmed the judgment below in all respects.

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[12] Although the defendants advanced a number of arguments on appeal, this summary focuses only on the issues relevant to the 144 Smith Place property.

First, the Court held that, although an oral promise to include a bequest in a will is unenforceable under the Statute of Frauds, quantum meruit was an available remedy on these facts because John had rendered valuable services in reasonable reliance on Sarah's promise. The Court held that the trial court's finding that Sarah had in fact made a promise to John was not clearly erroneous.

Second, the Court disagreed with the defendants' argument that only a portion of John's payments was made to his detriment. The Court held that where the quantum meruit damages were calculated by determining the amount necessary to avoid an injustice, the damages included the full value of the payments made by John.

Third, the Court affirmed the trial judge's finding of undue influence. The Court recited the standard of undue influence, which requires "that an (1) unnatural disposition has been made (2) by a person susceptible to undue influence to the advantage of someone (3) with an opportunity to exercise undue influence and (4) who in fact has used that opportunity to procure the contested disposition through improper means." The trial court's findings that (i) Sarah was close to incapacitated and near death at the time of the transfer of the 144 Smith Place property, and that (ii) the transfer was unnatural because it was contrary to her earlier promises to convey the property to John were not clearly erroneous.

Comment

This case is a nice example of the application of contractual and quasi-contractual concepts to testamentary dispositions of property. Estate planning attorneys should discuss with their clients any promises or commitments that are not reflected in the estate plan. At the same time, this case is a reminder that the risk of litigation and family strife can be minimized by timely planning.

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3. ADEMPTION

Rose v. Rose
80 Mass. App. Ct. 480 (2011)

Facts

Mary Rose, the testator, purchased two plots of land known as lot 7 and lot 8 in 1914 and 1932, respectively. The testator executed her last will and testament in 1962 and provided a life estate in lot 7 to her daughter, Mary Elizabeth Willis. Article 6 of her will bequeathed lot 8 to her son, Richard Henry Rose, and requested that her son allow Mary Elizabeth to have use of the garage on lot 8 so long as she occupied the house on lot 7. The residuary clause left 15% of the remainder to her five sons and 25% to Mary Elizabeth.

In 1967, the testator subdivided and re-designated lots 7 and 8. She designated lot 7 as "lot A" and divided lot 8 into "lot 1" and "lot 2." She then added lot 2 to lot A. Since 1968, lot 2 and lot A have been assessed as one lot. The testator later conveyed lot 1 to an unrelated party.

Mary died in 1983 without changing her will. The plaintiffs, Richard's heirs, claim ownership of that portion of lot 8 that was not sold.

Procedure

The plaintiffs filed a petition in the Norfolk Division of the Probate and Family Court. On summary judgment, the Probate and Family Court determined that the gift to Richard of lot 8 was a specific bequest that adeemed because lot 8 no longer existed after the testator subdivided the property, sold a portion of lot 8, and combined the rest with lot 7. The plaintiffs appealed to the Appeals Court of Massachusetts and the Court affirmed the Probate and Family Court's ruling.

Issue

Is a specific bequest of real property adeemed as a result of affirmative actions taken by the testator before her death but after she had executed her will?

Discussion and Decision

The Appeals Court found that the specific bequest of real property had adeemed because the 'testator caused such a substantial change in the form of lot 8 by conveying a large portion of it and combining the remainder with the original lot 7.'

Both sides agreed that the gift of lot 8 was a specific bequest. The dispute focused on the question of to what extent lot 8 had been adeemed. The plaintiffs argued that where only part of the real property owned by the testator is conveyed during lifetime, then only a partial ademption results. 80 Mass.App.Ct 482-83 (citing Hawes v. Humphrey, 9 Pick. 350, 360 (1830)). They argued that because not all of lot 8 was sold, the remaining portion belonged to them.

The defendants, on the other hand, maintained that a complete ademption had occurred. They argued that 'any alteration in the estate after the making of the will amounts to a revocation.' Id. at 482 (citing Moffatt v. Heon, 242 Mass. 201, 204 (1922). They also argued that when the specific bequest ceases to exist, then the legacy has no effect. Id. at 482 (citing Kelley v. Neilson, 433 Mass. 706, 711 (2001)). Therefore, the defendants stated that the plaintiffs had no right in the property.

The Court ruled for the defendants and upheld the Probate and Family Court's ruling that a complete ademption had occurred. The Court stated that in this case the change caused by the testator's affirmative act was substantial enough to cause a complete ademption of the bequest. Id. at 483. The Court found persuasive that after the merger the town had assessed lot 2 and lot A as a single unit and that the subdivision and subsequent combining came about due to the testator's own volition and not because of a local bylaw or zoning ordinance. Id.

Comment

The take away from this case is that whether an act of ademption occurs hinges primarily on the testator's affirmative acts. Also, the Court does not attempt to draw bright lines in determining when ademption occurs; instead, it finds the circumstances in this situation substantial enough to warrant a ruling of complete ademption. This suggests that whether an ademption has occurred will continue to be a fact specific analysis.

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4. RECEIVERSHIP

<u>Krawczyk v. Beng</u>
2011 Mass. App. Unpub. LEXIS 702 (May 24, 2011)

This decision is issued pursuant to Rule 1:28, is primarily addressed to the parties, and therefore may not fully address the facts of the case or the panel's decisional rationale. This decision may be cited for its persuasive value but not as binding precedent.

Facts

Plaintiff Vanessa Krawczyk was the trustee of the Grande Trust, the beneficiaries of which included an estate having a 50% beneficial interest. A parcel of property was owned by the trust. The defendants claimed to have a mortgage interest in the property, which they had attempted to foreclose on, contrary to court orders, on multiple occasions, leading to their having been repeatedly found in contempt of court.

A fire damaged the property. The defendants received a check from the property insurer, but they refused to endorse it to the trustee of the Grande Trust so that she could make repairs. The property was boarded up and fell into a state of disrepair.

Procedure

The trustee Krawczyk brought an action in Superior Court for the property to be placed in receivership. The Court appointed a receiver.

The defendants appealed and the Appeals Court affirmed the lower court ruling.

Issues

1. Can trust property be placed into a limited receivership to prevent waste and resolve disputed claims to the property?

2. Does a trustee have standing to petition for appointment of a receiver?

Discussion and Decision

1. The purpose of appointment of a receiver by a court is to prevent waste or loss and conserve the assets in question for the benefit of all parties with an interest in them. In this case, there were disputes about the validity of the mortgage and the rights of the parties to the parcel, which dispute prevented the trustee from avoiding its severe and substantial deterioration through neglect, which amounts to waste. Accordingly, the Court did not abuse its discretion by

appointing a receiver for the limited purpose of preventing deterioration and waste and protecting the interests of beneficiaries pending determination of the validity of the mortgage and the rights of the parties. The receiver was expressly prohibited from taking steps to convey the property without order of the court.

2. As the trustee of a trust with the fiduciary duty and obligation to protect the equity interest of a beneficiary in the property, the trustee had standing to petition for appointment of a receiver by the court. Contrary to the defendants' claims, a petitioner for appointment of a receiver need not be a creditor.

Comment

Petitioning for appointment of a receiver may be a useful tool for trustees where disputes have interfered with the trustee's ability to manage a parcel of property.

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5. PRO SE REPRESENTATION and FRIVOLOUS CLAIMS

Cohen v. Attorney General of the Commonwealth of Massachusetts
2011 U.S. Dist. LEXIS 120336 (D. Mass. Oct. 18, 2011).

Facts

Jillian M. Cohen, acting *pro se* as the purported administratrix of the Estate of Susan R. Lustgarten, along with various co-plaintiffs, twice brought civil actions in Massachusetts Superior court for negligence, products liability, and wrongful death against Brigham & Women's Hospital.

Procedure

A state court judge dismissed the first civil action for failure to state a claim and the second action on the grounds of *res judicata*. Both decisions were appealed by the Plaintiffs, but the appeals were dismissed by the Massachusetts Appeals Court. Plaintiffs then brought three separate wrongful death actions in Federal District court against a medical device manufacturer and its corporate parent. The federal court separately dismissed all three actions, the first for lack of standing by the Plaintiffs, and the second and third actions for continuing lack of standing and on the grounds of *res judicata* and collateral estoppel. Plaintiffs appealed the second dismissal, but it was affirmed. Plaintiffs repeatedly requested the Court of Appeals to re-hear or re-consider their case, which ultimately resulted in the court directing the clerk "not to accept any further filings in this appeal." Undeterred, the Plaintiffs then filed a motion to "void" the court's judgment, which the court denied and entered an order prohibiting the Plaintiffs from filing any further pleadings regarding claims of wrongful death. Five days after this order, Plaintiffs filed the instant action, which the court characterized as "unorganized and virtually incoherent," attempting to raise a constitutional challenge to state statutes. Defendant moved to dismiss.

<u>Issue</u>

May an administratrix acting pro se raise claims on behalf of an Estate?

<u>Discussion and Decision</u>

No, she may not.

In this instance, the Plaintiff administratrix asserted her claims in her capacity as "full statutory administratrix" of Susan R. Lustgarten's Estate. The court agreed that under *28 U.S.C. § 1654* and District of Massachusetts Local Rule 83.5.3(c), one may appear and practice before the court on his own behalf. However this authority is not broad enough to allow Plaintiff to represent others without being a duly-licensed attorney. In *Pridgen v. Andresen, 113 F.3d391, 393 (2d Cir. 1997),* the court held "an administratrix or executrix may not proceed *pro se* where the estate has beneficiaries or creditors other than the litigant." Here, there were several beneficiaries and creditors of the Estate other than the Plaintiff administratrix, therefore the court concluded that claims inuring to the Estate of Susan R. Lustgarten could only be prosecuted by a duly-licensed attorney.

As to the constitutional claim, the court found no plausible grounds upon which relief could be granted. The court also discussed its inherent authority to dismiss frivolous actions such as the instant action *suasponte* on the grounds that the Plaintiffs' complaint was frivolous, malicious, abusive and/or vexatious.

<u>Comment</u>

This case underscores the importance of attorney representation in cases in which there are multiple stakeholders involved in the administration of an estate. Estate attorneys should advise their clients that where multiple interests are involved, proceeding *pro se* as an administrator will not suffice.

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<u>ADDITIONAL CASES:</u>

6. DRAFTING and AMBIGUITIES

<u>Rachlin v. Forman</u>
2011 Mass. App. Unpub. Lexis 1123

This decision is issued pursuant to Rule 1:28, is primarily addressed to the parties, and therefore may not fully address the facts of the case or the panel's decisional rationale. This decision may be cited for its persuasive value but not as binding precedent.

<u>Facts</u>

Irving and Jannette Forman married in October 1984. Shortly thereafter, Irving executed a will dividing up his real estate as follows: "One third to my son ALAN H. FORMAN; One-third to my son MITCHELL H. FORMAN; and the remaining one-third to them equally upon the death of JannetteRachlin Forman but One-third to my wife JANNETTE RACHLIN FORMAN during her lifetime....Upon the sale of the said real estate, the net share which shall be due to my said sons shall be held in Trust by my executor or alternate executor pending the sale of said real estate or the death of JannetteRachlin Forman whichever shall take place first at which time said share shall be turned over to my said sons." 2011 Mass. App. Unpub. Lexis 1123 *2-3. The will went on to state that as long as the parties mutually agreed to sell the real estate then they should be allowed to do so. Id. at *3.

Irving died in 2006 and Jannette resided in the home until she moved to a nursing home in 2008. In August 2009, Jannette and Irving's two sons agreed to sell the home. Jannette died the following month.

Procedure

In December 2009, the executor of Irving's estate, Hillard Forman, filed a petition with the Probate and Family Court to interpret the above-quoted provision of the will. The parties stipulated that the matter could be decided on the papers. Id. at *4-5. Hillard argued that the will gave Jannette a life estate in one-third of the property ending at her death or a term estate ending when the realty was sold. Fran Rachlin, the executrix of the estate of JannetteRachlin Forman, argued that the will gave Jannette either a one-third interest in the net proceeds from the sale of the house with the remaining proceeds to be held in trust for her benefit or the value of a life interest in the net proceeds from the sale of the house with the remaining proceeds held in trust for her benefit. The probate judge held for Hillard and concluded the will gave Jannette an interest "that would terminate either upon her death or the sale of the property." Id. at *5. Fran Rachlin appealed the issue.

Issue

Whether Irving Forman's will created a term estate that ended with Jannette's death or whether the will created a one-third life estate with Jannette entitled to the proceeds from the sale of the property.

Discussion and Decision

Irving's will created a one-third life estate in Jannette that did not terminate upon the sale of the property but instead entitled her to the proceeds from the sale equal to the value of her life estate.

The Court began by citing the general legal principles it would follow in this particular case. To begin, although the Appeals Court's review is generally limited to whether the findings are clearly erroneous, the Court placed itself in the same position as the probate judge to decide the case because the evidence was documentary and no facts were disputed. Id. at *5 (citing Old Colony Trust Co. v. New England Merchs. Natl. Bank of Boston, 349 Mass. 303 307 (1965). The fundamental object of the Court was to implement the testator's intent from the whole document. Id. at *5-6 (citing Putnam v. Putnam, 366 Mass. 261, 266 (1974).

With these rules in mind, the Court held that the language unambiguously gave Jannette a life estate in the remaining one-third of the property and each of Irving's sons a one-half undivided remainder interest in fee simple in Jannette's life estate. Id. at *6 (citing Langlois v. Langlois, 326 Mass. 85, 87 (1950) ("the explicit phrase 'during her lifetime' creates the life estate."). As a result, Jannette was entitled to the value of her one-third life estate at the time the property was sold. The Court did not decide whether a trust was created to hold the proceeds of the sale as Jannette did not appeal the Probate Court's ruling that no trust was created. The Appeals Court remanded to the Probate and Family Court for the purpose of calculating the value of Jannette's life estate.

Comment

This case reminds us that clear drafting can help avoid litigation. The disposition in the will at issue was awkwardly written, and clearer language would have removed any difficulty in interpreting the testator's intent.

* * * * * *

7. GUARDIANSHIP, ROGERS ORDERS and NOTICE

Guardianship of Erma
Massachusetts Supreme Judicial Court
459 Mass. 801 (2011)

Facts

In February 2006, the Probate Court entered an order authorizing the administration of antipsychotic medications (a "Rogers order") for a woman with a permanent guardian ("Erma"). Before the annual review of the Rogers order occurred, Erma was committed by the District Court to a state hospital and the Rogers order lapsed. In February 2009, Erma was released from the state hospital. After Erma's release, the Department of Mental Health ("DMH") filed a motion to intervene with the Probate Court, along with a motion to reinstate the Rogers order and related treatment plan. Erma objected to both motions.

Procedure

After a hearing attended by Erma, her counsel, and her guardian, the Probate Court allowed the motions and reinstated the Rogers order. The Rogers order was scheduled for review in April 2010. Erma filed a timely appeal. The SJC transferred this case from the Appeals Court on its own initiative.

Issue

What documents must be served to satisfy the notice requirement for a hearing on a motion for substituted judgment treatment orders?

<u>Discussion and Decision</u>

The SJC concluded that under Mass. R. Civ. P. 6(c), a party filing a motion for entry of substituted judgment must provide all parties with at least 7 days notice by serving a copy of the motion along with a copy of every affidavit that will accompany the motion. The clinician's affidavit and medical certificate are deemed to be the equivalent of an affidavit. The DMH served Erma's counsel with the motions two weeks before the hearing. However, the clinician's affidavit and treatment plan were not provided to counsel until the day of the hearing, and thus the SJC found that proper notice was not given in this instance.

The SJC also addressed the issue of mootness: The Rogers order at issue expired in April 2010 and was not renewed at that time. Therefore, the SJC concluded that the appeal, though timely filed, was moot.

<u>Comment</u>

This case underscores the importance of serving adequate notice to those who are under guardianship. The SJC decision is reflective of a shift under Massachusetts law and the MUPC to provide greater safeguards for wards in guardianship matters.

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8. MEDICAID ELIGIBILITY

<u>O'Brien v. Medicaid</u>
2011 Mass. Super. LEXIS 136 (June 28, 2011)

This decision is rendered pursuant to the *interpretation of 130 Code Mass. Regs. 520.007(J)(1)-(2), which contain the conditions for preventing transfers to annuities from being disqualifying for MassHealth long term benefits.*

<u>Facts</u>

Laura O'Brien, plaintiff, is an elderly woman who was admitted to a nursing home on March 14, 2008. She is married to Leo O'Brien. Mr. O'Brien established the Leo O'Brien Irrevocable Trust on June 3, 2008 and funded it with $10 on that date. Nothing in the trust gives Mr. or Mrs. O'Brien the right to request or obtain distributions of income or principal. The O'Briens' two adult daughters are the beneficiaries and trustees. Mr. O'Brien entered into an agreement with the trustees on June 9, 2008 for a private, irrevocable, immediate annuity which named him as the annuitant and the trustees as obligors.

Mr. O'Brien sold the trustees/obligors life insurance and investment account assets valued at $594,595.92 in exchange for their promise to pay him $25,270.33 per month for two years beginning July 30, 2008. The total payments to Mr. O'Brien would be $606,000. The annuity names the Commonwealth of Massachusetts in first position for, at least, the total amount of medical payments for Mrs. O'Brien, otherwise to the issue of Mr. O'Brien by right of representation. Lastly, the annuity provides that the obligors' promise to pay is "totally unsecured" and that Mr. O'Brien "retains no security interest, encumbrance, lien or pledge with respect to the Property transferred…"

Mrs. O'Brien applied for MassHealth long-term care benefits on August 19, 2008 requesting eligibility as of June 10, 2008 and was denied benefits because MassHealth deemed Mr. O'Brien's transfer of $594,595.92 a disqualifying transfer.

Procedure

Mrs. O'Brien appealed and the Board of Hearings denied the appeal in a final decision issued on May 26, 2009. Mrs. O'Brien filed a Complaint for Judicial Review. The Board of Hearings was unable to produce the transcript for the prior hearing; thus, the court remanded the case to the Board for another hearing on the merits, which ended with a denial. Mrs. O'Brien appealed that decision to the superior court, and the current case considers Mrs. O'Brien's Motion for Judgment on the Pleadings.

Issue

Was the transfer of $594,595.92 to the trust a disqualifying transfer?

Discussion and Decision

MassHealth argued that Mr. O'Brien's transfer to the trust was disqualifying because it was for less than fair-market value and was made for the sole purpose of qualifying for long-term care benefits for Mrs. O'Brien. Mrs. O'Brien argued that MassHealth's conclusion was an error of law because under the applicable MassHealth regulations, annuities, whether commercial or private, are not disqualifying transfers.

The hearing officer reasoned, among other things, that once Mrs. O'Brien received benefits, there would be no incentive for Mr. O'Brien to seek enforcement of the private annuity provisions because the goals of Mr. and Mrs. O'Brien and their daughters differ from the goals of a purchaser and a company in the business of selling annuities. The court noted that the hearing officer ignored the terms of the O'Brien annuity contract. In addition, the court noted that MassHealth's decision was based on errors of law and was arbitrary and capricious.

The decision of the Board of Hearings to uphold MassHealth's denial of Mrs. O'Brien long-term care benefits was vacated and the Motion for Judgment on the Pleadings was allowed.

Comment

This case demonstrates the importance of drafting documents in strict conformance with the rules. Because the private annuity document in this case contained all the necessary provisions, the court found in favor of Mrs. O'Brien.

* * * * * *

9. REPUDIATION and BREACH OF TRUST

Kostick v. Fort Hill Community
2011 Mass. App. Unpub. LEXIS, 697

This decision is issued pursuant to Rule 1:28, is primarily addressed to the parties and, therefore, may not fully address the facts of the case or the panel's decisional rationale. This decision may be cited for its persuasive value but not as binding precedent.

Facts

Fort Hill is a commune established in the 1960's by Melvin Lyman. In 1969, Lyman established the United Illuminating Trust to manage the proceeds from development projects engaged in by members of Fort Hill. Fort Hill members were the sole beneficiaries of the Trust, and the Trustees were required to "pay all the beneficiaries the net income or such portion as the trustees shall deem available." A member of Fort Hill remained a member until he either (i) ceased living with the members of Fort Hill, or (ii) the Trustees voted by a four-fifths margin to deny him membership. A member who is no longer a member under either test is no longer "entitled to any compensation or share of the trust assets".

Plaintiff John M. Kostick became a member of Fort Hill in 1971. Over time, Kostick's relationship with the Trustees deteriorated, and in 1993, Kostick was asked to leave Fort Hill, but without a four-fifths vote of the Trustees expelling him. In November, 2008, claiming he was still a member of Fort Hill, Kostick demanded his beneficial interest in the Trust. The Trustees rejected his demand in December, 2008.

Procedure

Kostick filed an action against the Trustees for breach of trust with the Superior Court in 2009. The Superior Court dismissed Kostick's complaint for failure to state a claim. Prior to the entry of judgment, Kostick moved to amend. The judge considered the proposed amendment, but denied the motion to amend on the grounds that the amended complaint still failed to state a claim. This appeal followed.

Discussion and Decision

1. Statute of Limitations. Defendant claimed that Kostick's claim was barred by the statute of limitations. Under *Demoulas V. Demoulas Super Mkts., Inc., 242 Mass. 501 (1997),*"[A] cause of action [arising out of a breach of trust or fiduciary duty] does not accrue until the trustee repudiates the trust and the beneficiary has actual knowledge of that repudiation." Here, the court reasoned that although the Trustees removed Kostick from Fort Hill in 1993; pursuant to the requirements of the trust agreement, Kostick remained a member of the trust when he made his claim for beneficial interests. As such, the trustees did not repudiate the trust as to Kostick until they rejected his demand in December, 2008. Therefore, the court found Kostick's claim was timely.

2. Right to Trust Share. Kostick claimed that as a member of Fort Hill, he was entitled to a share of the trust income. The court found that Kostick remained a member of Fort

Hill even after he was asked to leave in 1993, and therefore remained a member until the trustees rejected his demand in December, 2008. The court ruled that Kostick's right as a beneficiary of the Trust to a beneficial interest and composition of such interest were matters for further review and could not serve as the basis for a dismissal for failure to state a claim.

3. Motion to Amend Complaint. The court found Kostick's original complaint stated a valid claim, therefore the amended complaint should not have been dismissed. The court remanded the matter for further consideration of Kostick's amended complaint.

Comment

Although the exact facts of this case are unlikely to be repeated, it does remind us of the importance of following the terms of a trust instrument.

* * * * * *

10. TESTAMENTARY CAPACITY and UNDUE INFLUENCE

Paine v. Sullivan
79 Mass. App. Ct. 811 (2011)

Facts

John and Odette were married in 1956 and had two adopted daughters, Annabelle and Valerie. John and Odette became estranged from Annabelle in 1995, and later that year, John executed a will omitting Annabelle and leaving everything Odette, and to Valerie if Odette predeceased him. In 2000, Valerie had a falling out with Odette and was banished from the family home. Although John never forgave Valerie, he continued to love and miss her.

Odette was the "boss" at home, and in most areas throughout their marriage John happily acceded to her wishes. Odette always took the lead on the couple's estate planning.

Odette was diagnosed with cancer in late 2001. In 2002, she had their attorney update the 1995 wills so that upon the death of the survivor of them, Valerie would receive $1 and the residuary of their estates would pass to friends of Odette. New wills were executed in 2003 and 2004 in which minor changes were made to the residuary beneficiaries. Although the attorney who drafted the new wills routinely spoke with Odette about estate planning, after 2000, he spoke with John only by telephone. In those conversations, John simply confirmed that he agreed with the instructions given by Odette. The attorney was unaware that John had been diagnosed with dementia and did not have any private conversations with John, visit John, or read the documents to John after they were drafted. The attorney mailed the documents to John and Odette, who executed them at a local bank. The witnesses could not recall the specifics of the signing, but indicated that John did not display any outward signs of confusion or appear to be forced to execute the will.

Beginning in 2001, John's medical records indicate varying degrees of difficulty with insight, judgment, memory, cognitive slowing and disorientation as to time. At that time, Odette took over managing the family's finances because John had become "confused" about the taxes. John began to receive personal care assistance when Odette was at work. By 2003, John had a personal care attendant 24 hours per day. In 2004, a medical report noted that he had progressive mild dementia.

Odette died in 2004. After Odette's death, Valerie took care of John. John died in 2006 and his 2004 will was allowed. Valerie contested the will, arguing that John lacked testamentary capacity when he executed the 2004 will, and that the will was the product of undue influence exerted by Odette.

Procedure

The trial court essentially adopted the opinion of the proponent's expert (the defendant in this appeal), who described John's dementia as mild and noted that John's doctors continued to direct their reports to him, explain test results to him, and include him in making treatment decisions for himself. The trial court found for the proponent, holding that John possessed testamentary capacity and that the will was not the product of undue influence. The plaintiff (Valerie) appeals.

Issue

Was the trial court correct in finding that John had testamentary capacity and that he was not unduly influenced?

Discussion and Decision

In reviewing issues of testamentary capacity and undue influence, the findings of the trial court will not be reversed unless they are plainly wrong.

Valerie argues that the 2002 through 2004 wills are the product of undue influence exercised by Odette over John. Four considerations must be present to show undue influence: (1) an unnatural disposition was made (2) by a person susceptible to undue influence to the advantage of someone (3) with an opportunity to exercise undue influence and (4) who in fact used that opportunity to procure the contested disposition through improper means. John had acceded to Odette's wishes for many years and there was no evidence of coercion with regard to the wills. In fact, the final will contained a residuary beneficiary that was closer to John than to Odette. Moreover, given that John acquiesced in banning Valerie from the home in 2000, the will cannot be said to be an unnatural disposition. Finally, Odette did not benefit from the 2002–2004 wills any more than she did the 1995 will. Accordingly, it cannot be said that the trial court was wrong in finding no undue influence.

Valerie also argues that John lacked the testamentary capacity to execute the 2002 through 2004 wills. Where there is some evidence of lack of testamentary capacity, the presumption of sanity loses effect and the burden is on the proponent of the will to prove capacity by a preponderance of the evidence. Capacity requires that the testator was able to understand the nature and situation of his property and the natural objects of that property, that he was free from disease or weakness that might influence the disposition of his property and that he was able to comprehend the act of making a will at the time of execution. The evidence of John's cognitive deficits was sufficient to overcome the presumption of capacity and the plaintiff did not meet the then burden of proving that John had capacity. The plaintiff's medical expert "cherry picked" the portions of the medical records suggesting that John's dementia was mild. Moreover, John's ability to participate in medical decisions where treatment options were clearly explained does not support the inference that he possessed testamentary capacity where his options were not explained and he was never asked to articulate the choices he made. In light of the fact that the drafting attorney had not seen John in a number of years, only spoke to him by phone, and that John simply verified that he wanted what Odette wanted, the trial court erred in crediting the attorney with the degree of care and attention appropriate to the issue of capacity. The witnesses to the execution of the will also could provide no relevant evidence of capacity.

The proponent failed to meet the burden of proving that John possessed testamentary capacity when he executed the will. The trial court's judgment is reversed. The matter is remanded for proceedings as to the validity of the 1995 will, which was also offered for probate.

Comment

This case underscores the importance of direct contact with estate planning clients and mindfulness of the client's testamentary capacity, particularly where a testator's natural heirs are omitted or receive different treatment under an estate plan.

* * * * * *

11. TRUST REFORMATION and IN TERROREM CLAUSE

CHARLES LEE AUSTIN VS. JOHN BRADBURY AUSTIN & OTHERS

2011 Mass. App. Unpub. LEXIS 870 (July 7, 2011)

This decision is issued pursuant to Rule 1:28, is primarily addressed to the parties and, therefore, may not fully address the facts of the case or the panel's decisional rationale. This decision may be cited for its persuasive value but not as binding precedent.

Facts

The Plaintiff, Charles Lee Austin, and the Defendant, John Bradbury Austin, are the sons of the Decedent, Louis B. Austin. In 2001, the Decedent had her attorney draft an estate plan so as to provide a "roughly equal" division of her assets among her sons. As part of the estate plan, a parcel of land passed to the Plaintiff via a Qualified Personal Residence Trust ("QPRT"). As a result of the administrative terms of the Decedent's Will and the parcel passing through the QPRT to the Plaintiff, the Plaintiff paid more taxes than the Defendant. (While the record is unclear on the source of the Plaintiff's additional tax bill, it is likely that the Plaintiff incurred capital gain taxes on the subsequent sale of the real estate he received as a beneficiary of the QPRT as said property would not receive a step up in basis as a result of the Decedent's death.)

Procedure

The Plaintiff filed a complaint for reformation of the QPRT, stating that the settlor's intent was frustrated by scrivener's error, which error resulted in his larger tax bill and a smaller inheritance as compare to that of his brother. To rectify the "error", the Plaintiff asked the court to amend the QPRT such that the taxes the Plaintiff incurred as a result of the receipt and subsequent sale of the real estate would be paid out of the residue of the Decedent's estate.

The Defendant filed a Motion for Summary Judgment and asked the trial court to enforce an in terrorem clause contained in the Decedent's Will as the requested QPRT reformation would "indirectly" frustrate a tax allocation clause in said Will. On March 27, 2008, the judge granted the Motion for Summary Judgment and ruled that the in terrorem clause contained in the Decedent's Will would be enforced.

The Plaintiff filed an appeal stating that a genuine dispute of material fact remained regarding the Decedent's intent in drafting her Will and QPRT and that the in terrorem clause contained in the Decedent's Will should not be enforced in response to his complaint for reformation of the QPRT.

Issue

1. What evidence must be presented to proceed with a Complaint for Reformation of a Trust under G.L.c. 215, § 6 due to scrivener's error?

2. Can a complaint for reformation of a provision in a Trust trigger an in terrorem clause in a Will if the Trust does not contain a counterpart in terrorem clause?

Discussion and Decision

On appeal, the Plaintiff argued that the probate court erred in granting the Motion for Summary Judgment as a genuine dispute of material fact remained regarding the Decedent's intent in drafting her Will and QPRT. According to the Plaintiff, the Decedent's intent was frustrated by scrivener's error, which error resulted in his larger tax bill, and consequently smaller inheritance, as compare to his brother's.

The reformation of an irrevocable trust document is permitted under G.L.c. 215, § 6 when the document is ambiguous as to the settlor's intent. Extrinsic evidence may show the settlor's intent and whether the scrivener failed to carry out that intent. *Putnam v. Putnam, 425 Mass. 770, 772, 682 N.E.2d 1351 (1997).* As evidence of this error, the Plaintiff introduced a letter written in 2001 from the Decedent's attorney to the Decedent summarizing the newly drafted estate plan which provided for a "roughly equal" inheritance for her two sons.

However, the Defendant pointed to a subsequent provision of the same 2001 letter which restated the Decedent's decision to not obtain appraisals for her assets, even though doing so would provide additional assurances of a more equal division of her assets. Furthermore, the Decedent's attorney provided an affidavit stating that the Decedent did not use the term "equal" when discussing her sons' inheritances, rather the affidavit stated that her intent was to provide a "fair and appropriate division of her assets". The affidavit went on to state that not only were the planning documents unambiguous, they were a clear reflection of the Decedent's intent. In fact, the Plaintiff conceded that "equalizations" provisions in the Decedent's Revocable Trust had been removed and were not included in the final version of said Trust. The Plaintiff offered no other evidence that a genuine dispute of material fact remained regarding the Decedent's intent in drafting her Will and QPRT. The Appeals Court held that because the Plaintiff failed to provide any evidence of a genuine dispute of material fact regarding the Decedent's intent in drafting her Will and QPRT, the summary judgment was properly granted to the Defendant.

The Plaintiff also argued on appeal that the trial court erred in enforcing the in terrorem clause contained in the Decedent's Will in response to his complaint for reformation of the QPRT. Pursuant to Article Sixteen of the Decedent's Will, if a beneficiary challenged a provision of the Will, or of the Decedent's Revocable Trust, from being carried out, "either directly or indirectly", that the Will would be construed as if such beneficiary had predeceased the Decedent. During the trial, the Defendant argued that the Plaintiff's requested reformation of the QPRT would have frustrated the Will's tax allocation provision from being carried out. According to that provision, no taxes for any Trust created by the Decedent, other than the Revocable Trust, could be paid out of the residuary of her estate. The Appeals Court agreed that the reformation would frustrate the Decedent's Will and upheld the trial court's decision to enforce the in terrorem clause.

<u>Comment</u>

This case is a reminder that attorneys should always take careful notes when meeting with clients to discuss their estate plan. Additionally, attorneys may want to include a diplomatic reference to any advice a client declined to follow in a summary of the proposed or executed estate planning documents. Attorneys may also want to consider including a sentence or two regarding the settlor's intent in each Will or Trust. These provisions may be especially helpful in situations where the settlor intends to incorporate distinctive allocations to some or all of his/her intended beneficiaries.

Furthermore, as attorneys continue to use multiple estate planning vehicles, as opposed to a simple Will or pour-over Will and Revocable Trust, they need to consider how each document stands alone and how it relates to the other pieces of the client's estate plan. Accordingly, if an in terrorem clause is going to be included in any of the documents, counterpart in terrorem provisions should be included in all of the client's estate planning documents and the provisions should state that a challenge to any one document is a challenge to all of the documents. Including the provision "either directly or indirectly" or similar language in an in terrorem clause may provide the settlor's representatives substantial leverage for discouraging a Will contest or "hostile" reformation of a Trust.

* * * * * *

12. STANDING TO INTERVENE and *CY PRES*

<u>Hoffman v. Univ. of Mass. Amherst, et al.</u>
79 Mass. App.Unpub. LEXIS 731 (June 2, 2011)

This decision is issued pursuant to Rule 1:28, is primarily addressed to the parties and, therefore, may not fully address the facts of the case or the panel's decisional rationale. This decision may be cited for its persuasive value but not as binding precedent.

Facts

Stanley Jez created the Stanley Jez Testamentary Trust (the "Trust") which provided scholarships to boys of two particular Roman Catholic parishes to study forestry at Paul Smith's College ("Paul Smith's") or the University of Massachusetts at Amherst ("UMass"). Because of the parishes decreasing populations and the restriction to study forestry, the trustee and the colleges were doubtful that scholarships could be awarded on an annual basis. From 2002-2006, no applications for scholarships were received from parishioners. In 2007, the trustee of the Trust brought a *cy pres* action to broaden the group of potential beneficiaries of the Trust. The trustee's application for *cy pres* was granted with the consent of the Attorney General.

Under the terms of the cy*pres* judgment, the courses of study are expanded beyond forestry to forestry and environmental studies at UMass or any other major at Paul Smith's. Furthermore, upon resignation of the current trustee, the Trust fund would be divided equally between UMass and Paul Smith's to be administered by the colleges as scholarship funds on the same terms. Finally, the *cy pres* judgment expanded the class of eligible beneficiaries to a tiered system in the following order: (1) male and female students from the two designated parishes; (2) other Catholic students in the diocese; (3) Catholic students recommended by the Roman Catholic Bishop of Springfield ("RCB"); (4) Catholic students recommended by other Catholic bishops in the Commonwealth; and (5) other eligible students in Forestry or other Environmental Studies programs.

Procedure

In 2009, the RCB filed a motion to intervene pursuant to Rule 24 and a motion for relief from the judgment pursuant to Rule 60(b)(6). Those motions were denied. The RCB appealed, and the Appeals Court affirmed the lower court ruling.

Issues

1. Did the RCB have standing to intervene in this matter?

2. Was there "substantial justice" to accomplish that would justify allowing the motion for relief for judgment?

3. Was the RCB entitled to notice of the trustee's *cy pres* petition?

Discussion and Decision

1. Standing. In ruling that the lower court was correct in finding that the RCB did not have standing to intervene, the Appeals Court first stated that the correct standard of review for motions to intervene and for relief from judgment is for an abuse of discretion.

The Appeals Court noted that "it is the exclusive function of the Attorney General to correct abuses in the administration of a public charity by the institution of proper proceedings." *See Lopez v. Medford Community Center, Inc.*, 384 Mass. 163, 167 (1981). In order for an individual plaintiff to have standing to bring a claim, the plaintiff must have an individual interest in the charitable organization that is distinct from that of the general public. *See id.*

Here, the Appeals Court found there was no abuse of discretion by the lower court because even though the RCB is the legal entity that operates the two parishes in question, the RCB is not a legal beneficiary of the Trust. Indeed, under the terms of the Trust, neither the parishes nor the RCB are intended beneficiaries. Instead, the testator intended to benefit Catholic males from the two designated parishes who would be attending the two colleges and studying forestry. Because it was not an intended beneficiary of the Trust, the RCB failed to establish that it had an individual interest that existed apart from any broader community interest, and it therefore lacked standing to intervene.

2. <u>Relief from Judgment</u>. The Appeals Court found that even if the RCB had standing to intervene, there was no abuse of discretion by the lower court in granting the *cy pres* petition. The Court notes that "it is not beyond the scope of the *cy pres* doctrine that, although members of the defined or special class must be given preference in devising a scheme to dispose of the property *cy pres*, members of the general class described may also receive the benefits of the trust." *Rogers v. Attorney Gen.,* 347 Mass. 126. The Appeals Court held that the judgment properly gives preference to Catholic students from the two designated parishes, and if the RCB can effectively improve its recruiting efforts, it will be unnecessary to resort to the failsafe provision.

The Appeals Court questioned the lower court's ruling to allow the colleges to act as successor trustees, as it may prove difficult, if not impossible, for UMass, as a public university, to honor the testator's intent to benefit Catholic students, but the Court found there was no abuse of discretion. Furthermore, the Court stated that the Attorney General's monitoring will prevent frequent resort to the Trust's failsafe provisions.

3. <u>Notice</u>. The Appeals Court found the RCB was not entitled to notice of the *cy pres* complaint because the statute only requires notice in *cy pres* cases to heirs and other takers in default, and even if the charitable gift did fail, the RCB would not have been an heir or taker.

<u>Comment</u>

This case reminds us that only plaintiffs with individual interests in a charitable organization that are distinct from the general public's interest, will have standing to intervene in a petition for *cy pres.*

* * * * * *

13. DESIGNATION OF BENEFICIARY

<u>Langevin v. McMorrow</u>
2011 Mass. App. Unpub. LEXIS 810 (June 20, 2011)

This decision is issued pursuant to Rule 1:28, is primarily addressed to the parties and, therefore, may not fully address the facts of the case or the panel's decisional rationale. This decision may be cited for its persuasive value but not as binding precedent.

Facts

John Iacono ("John") married Maria McMorrow ("Maria") in 1969. In 1984, John designated Maria as the beneficiary of his 401(k) retirement plan (the "Plan"). Thereafter, in 1989, John and Maria divorced. The divorce judgment incorporated a marital agreement under which Maria waived, among other things, any rights to John's pension plan. In addition, the marital agreement provided that the parties had the right to dispose of their own property in a manner each deemed proper and that each party would execute all instruments as may be necessary to carry out the terms of the agreement.

After the divorce, John never changed the beneficiary designation of the Plan and, at his death in 2008, Maria was named as the sole beneficiary. During his lifetime, John made administrative changes to the Plan regarding personal information, online access, and investment objectives, but never changed the beneficiary designation. In addition, with respect to other assets, including his employer's stock option plan, John changed the beneficiary designation after the divorce.

At John's death, Jayne Langevin ("Jayne"), as executrix of his estate tried to collect the proceeds from the Plan. John's employer refused to distribute them to Jayne, as Maria was the named beneficiary. Jayne requested that Maria disclaim any interest she had in the Plan, but Maria refused to sign a disclaimer. In 2009, John's employer paid the Plan proceeds to Maria.

Procedure

Jayne, on behalf of the estate, filed a claim in equity and a contempt claim in the divorce matter against Maria in the Probate and Family Court. The judge granted Maria summary judgment on the equitable complaint and dismissed the contempt complaint. Jayne appealed and the Appeals Court affirmed the lower court's ruling.

Issues

1. Is the estate entitled to the Plan proceeds despite Maria being named as the designated beneficiary?

2. Did Maria breach the marital agreement by accepting the Plan proceeds and, if so, is Maria in contempt for violating the divorce judgment?

Discussion and Decision

1. The Appeals Court cites <u>Kennedy v. Plan Administrator for DuPont Sav. & Inv. Plan</u>, 555 U.S. 285 (2009), which held that "the administrator of an ERISA plan was required to pay a former wife proceeds of her former husband's pension, notwithstanding her waiver of those benefits in their divorce decree, because the former wife was named beneficiary in the plan's documents." 2011 Mass. App. Unpub. LEXIS 810, 2. In addition, the Appeals Court cites

Staelens v. Staelens, 677 Fed. Supp. 2d 499 (D. Mass. 2010), which held that a participant in an ERISA plan has complete control over the distribution of the plan benefits and the designation of beneficiary is a clear indication of the participant's intent for the distribution of those benefits at death. 2011 Mass. App. Unpub. LEXIS 810, 2. Based on this analysis, the Appeals Court held that Maria was entitled to the Plan proceeds, regardless of the divorce judgment (which incorporated the marital agreement), as she was the designated beneficiary of the Plan.

2. On the alleged violation of the divorce judgment, the Appeals Court held that since the marital agreement provided that "John was free 'to dispose of his…property by Will or otherwise," John was free to change the beneficiary designation of the Plan. 2011 Mass. App. Unpub. LEXIS 810, 2. By not changing the designated beneficiary of the Plan, John chose to give Maria those benefits and Maria was entitled to receive the proceeds at John's death. Maria is not in violation of the divorce judgment and the Appeals Court affirmed the dismissal of the contempt claim.

Comment

Under the Massachusetts Uniform Probate Code (MUPC), divorce or annulment revokes any revocable disposition to a former spouse, including retirement plan beneficiary designations. As a result, the holding in this case may be irrelevant once MUPC takes effect.

* * * * * *

14. TRANSFER OF LLC MEMBERSHIP INTERESTS

Furman v. Gossels
28 Mass. L. Rep. 364 (Mass. Sup. Ct. 2011)

Facts

200 High LLC (the "LLC") is a Massachusetts limited liability company that owns commercial real estate in downtown Boston. The operating agreement (the "Agreement") governing the LLC was executed by Elaine Gossels, Jerome Furman, and Walter Furman. Although the Agreement did not define the term "Member," it listed Elaine, Jerome, and Walter as the members on an exhibit to the Agreement. Elaine was named as manager of the LLC.

The Agreement also provided that only descendants of Mr. and Mrs. Furman (parents of Elaine, Jerome, and Walter) could be members of the LLC. Under a transfer restriction clause, transfers of ownership interests to trusts were permitted only if all of the beneficial interests in the recipient trust were owned by one or more members of the LLC or their descendants, and only if the trustee of the trust was a member. In the event of an impermissible transfer, the LLC had an option to purchase the transferred interest at a 20% discount.

After Walter's death, his interest in the LLC passed first to a family trust and then, following a disclaimer by Walter's wife, to a trust for his children, of which Walter's daughter Rebecca was trustee and a beneficiary.

Shortly after Walter's death, Elaine, as manager of the LLC, notified Rebecca that the LLC was intending to exercise its purchase option with respect to Walter's interest on the ground that the trustee of the children's trust was not a member of the LLC. Rebecca rejected the notice and promptly filed a complaint.

Procedure

The trustee of the children's trust brought a complaint asserting claims for breach of contract, breach of fiduciary duty, declaratory judgment, and others. The defendants moved to dismiss and the plaintiffs moved for summary judgment on the claim for declaratory judgment seeking a declaration that Rebecca, as trustee, owned Walter's interest in the LLC.

Issue

Did Rebecca, as a result of Walter's death and his wife's disclaimer, hold an ownership interest in the LLC and was she therefore a member of the LLC?

Discussion and Decision

The plaintiffs argued that on Walter's death legal title to his interest in the LLC passed to Rebecca, as trustee, at which point she became a member. In addition, the plaintiffs argued that the beneficiaries of the children's trust also became members of the LLC. The defendants responded that the trustee was not a member.

The Superior Court held for the plaintiffs. The Court employed familiar standards of contract interpretation and looked to the plain meaning of the contractual language independent of extrinsic evidence unless the contract was ambiguous. The Court concluded that although the Agreement did not define the term "Member," a person who possessed an ownership interest in the LLC was a member. It was not dispositive that a member was or was not listed on the schedule to the LLC agreement.

Relying on black-letter trust law that a trustee of a trust holds legal title while a beneficiary holds an equitable interest in the trust property, the Court concluded that Rebecca and her siblings, as beneficiaries of the children's trust, held an equitable interest in the trust property and became the real owners. Therefore, Rebecca was a member of the LLC and Walter's interest in the LLC held by the children's trust was not subject to the LLC's purchase option.

Comment

This case demonstrates the importance of clearly defining the rules for admission of new members and transfer of membership interests in LLC agreements.

* * * * * *

15. CHARITABLE EXEMPTION FROM REAL ESTATE TAXES

<u>Board of Assessors of Bridgewater vs. Bridgewater State University Foundation</u>, 79 Mass. App. Ct. 637 (June 7, 2011)

Facts

The Bridgewater State University Foundation ("Foundation") was established in 1984 and is organized and operated pursuant to G. L. c. 15A, § 37, exclusively for the benefit of Bridgewater State University ("University"). The Foundation owns several buildings and parcels of land in the town where the University is located. The Foundation had leased certain buildings to the University for $1.00 per year per building. There was never a lease agreement between the Foundation and the University with respect to a separate building and certain undeveloped land that the University was using. While the Foundation occupied a portion of one property for its offices and occasionally used that same property for fundraising events, the University was the primary occupier of the properties. The University's occupancy was for use and in a manner consistent with the Foundation's purpose.

The Foundation is entitled to a charitable exemption from real estate taxation under G. L. c. 59, § 5, Third. For the charitable exemption to apply, however, the statute requires occupancy by the charitable organization claiming exemption, or by another charitable organization, coupled with use for purposes consistent with the charitable purposes of the occupying charitable organization. The Appellate Tax Board concluded that the properties are tax-exempt because the Foundation "occupied" the properties, including the portions used by the University, reasoning that the use of the properties by the University in furtherance of the Foundation's charitable purposes constitutes occupancy of the property by the Foundation, within the meaning of the statue.

Procedure

In this case, the decision of the Appellate Tax Board is being appealed to the Appeals Court of Massachusetts. The Appellate Tax Board held that the properties owned by the Foundation are exempt from real estate taxation in accordance with the charitable exemption from real estate taxation under G. L. c. 59, § 5, Third. The decision of the Appellate Tax Board is reversed.

Issue

Is the charitable exemption from real estate taxation under G. L. c. 59, § 5, Third applicable with respect to properties owned by the appellee Foundation but used in whole or in part by the University?

Discussion and Decision

1. G. L. c. 59, § 5, Third requires "occupancy" of the property by the charitable organization claiming exemption from real estate taxation. In rendering its decision, the Appellate Tax Board determined that "occupancy" was satisfied so long as the properties were used for purposes consistent with the Foundation's charitable use, without regard to who

conducted such use. However, the Appeals Court noted that "construing occupancy solely by reference to the purposes for which the property is used would render superfluous the statute's reference to occupancy by the charitable organization." 2011 Mass. App. LEXIS 841, *3. The Foundation must occupy the property for purposes consistent with the Foundation's charitable use or another charitable organization must do the same for the exemption to apply.

2. The Appeals Court decision makes note of the fact that the University is separately entitled to exemption from real estate taxes for property it occupies under the G. L. c. 59, § 5, Second. So the conclusion has the effect of subjecting to taxation properties that would be exempt if occupied by the charitable organization that owns them, or if owned by the state university that occupies them.

Comment

The decision points out that charitable organizations must be careful to conform the occupancy and use of their property to the dual requirements set forth in G. L. c. 59, § 5, Third in order to claim exemption from real estate taxation.

* * * * * *

16. MUTUAL MISTAKE AND AMBIGUITY

Cherubini v. Goodsell,
2011 Mass. App. Unpub. LEXIS 827 (June 24, 2011)

This decision is issued pursuant to Rule 1:28, is primarily addressed to the parties and therefore, may not fully address the facts of the case or the panel's decisional rationale. This decision may be cited for its persuasive value but not as binding precedent.

Facts

Dominic Cherubini had a son named Donald Goodsell. Donald had seven children of his own (Dominic's grandchildren), among them Edward Goodsell. Donald died before his own father. When Dominic (the grandfather) later died, his will left Donald (already deceased) a share of his estate.

At some point before the grandfather's death, all of Edward's siblings assigned their interests in *their father's* (but not their grandfather's) estate to Edward.

Procedure

It is unclear from the Appeals Court decision who brought the initial action in the Probate and Family Court. In that action (likely brought by Edward or by the executor), Edward argued that the executor of Dominic's (the grandfather's) estate should be compelled to honor his siblings' assignments with respect to Donald's (the father's) estate, and to distribute the father's share of the grandfather's estate to Edward. The Probate and Family Court disagreed, and instructed the executor of Dominic's estate to distribute Donald's portion of Dominic's estate to

Donald's children, by right of representation, disregarding the purported assignments to Edward by his siblings.

Edward appealed, arguing that the language of the assignments should be construed to include both estates. He sought remand to the Probate and Family Court for an evidentiary hearing as to whether the assignments were intended to include Dominic's (the grandfather's) estate, and not just the father's estate.

Issues

Do the doctrines of mutual mistake and/or ambiguity allow the assignments to be construed to include both Dominic's and Donald's estates?

Discussion and Decision

M.G.L. c. 191, § 22, sometimes referred to as the "anti-lapse statute," provides in relevant part as follows:

> "If a devise or legacy is made to a child or other relation of the testator, who dies before the testator, but leaves issue surviving the testator, such issue shall, unless a different disposition is made or required by the will, take the same estate which the person whose issue they are would have taken if he had survived the testator…This section shall apply to a devise or legacy under a class gift whether the death occurred before or after the execution of the will."

Edward claimed that neither he nor his siblings were aware of the anti-lapse statute; rather, they had assumed when they executed the assignments that Donald's share of Dominic's estate would pass through Donald's own estate, where it could be governed by the assignments. The Appeals Court characterized Edward's arguments as a conflation of two distinct theories: mutual mistake and ambiguity.

"A mutual mistake occurs when 'the language of a written instrument does not reflect the true intent of both parties.'' While reformation is available in cases of mutual mistake, "[t]o be entitled to reformation, a party must present full, clear, and decisive proof of mistake." Unfortunately for Edward, the Appeals Court agreed with the Probate and Family Court that Edward failed to meet this "high bar," holding that Edward's contentions were unsupported by his siblings, the language of the various assignments, or any other extrinsic evidence. As such, he was not entitled to reformation of the assignments on the basis of mutual mistake.

"Where contractual language is ambiguous, extrinsic evidence is admissible to aid in its construction." Unfortunately again for Edward, the Appeals Court held that "we perceive no ambiguity in the language of the agreements. By their express terms, [the] agreements pertain exclusively to the estate of Donald Goodsell." Accordingly, Edward was not entitled to an evidentiary hearing to determine the agreements' meaning.

Comment

This case highlights the importance of careful drafting, and the relative difficulty of obtaining reformation on the ground of mutual mistake or ambiguity.

* * * * * *

17. SUMMARY JUDGMENT and FIDUCIARY LIABILITY

Harootian v. Douvadjian
80 Mass. App. Ct. 565 (October 4, 2011)

Facts

Arthur Ansbigian created the Arthur Ansbigian Trust (the "Trust") in 2001, naming his wife Beatrice and himself as co-trustees. The Trust provided in relevant part that upon Arthur's death, with Beatrice surviving, the trustees had the power to pay income and principal "for the support in reasonable comfort and maintenance of [Beatrice]." The plaintiff, George Harootian ("George"), was named as remainder beneficiary of the Trust. Arthur died on February 28, 2003, which resulted in Beatrice being the sole trustee and lifetime beneficiary of the Trust.

Following Arthur's death, Beatrice made the following distributions from the trust which George claimed to be improper: First, Beatrice spent $58,648 of principal to pay taxes assessed against the trust and Beatrice personally. Second, Beatrice paid the defendant, Michael Douvadjian, $7,940 as compensation for various services he provided to her in the final months of her life, including paying Beatrice's expenses, running errands and coordinating medical care. Finally, Beatrice failed to return to the trust a $153,450 rebate check from an assisted living facility, representing partial repayment of $165,000 originally paid to the facility from the trust.

Procedure

George brought an action in the Superior Court alleging that the transactions described above violated the terms of the Trust, breached fiduciary duties owed to him as a remainder beneficiary, and constituted conversion of property in which he had and interest. More specifically, George alleged that Beatrice should have been required to use her own assets before those of the trust. The Court found for the defendant and against George, granting the defendant summary judgment.

George also alleged in the Superior Court that he should have been appointed a co-trustee with Beatrice following Arthur's death. Although the exact terms of the trust instrument are unclear from the decision, it appears that the trust instrument did, in fact, name George as a co-trustee with Beatrice following Arthur's death. Even so, a jury in the Superior Court found that this was a scrivenor's error, and that it was Arthur's intent, in the event he died before Beatrice, that Beatrice would serve as the sole trustee during her life. Since the "language [did] not conform to the settlor's intent," reformation of the trust was appropriate, and the Superior Court held that George was not entitled to become a trustee until both Arthur and Beatrice ceased to serve.

George then brought this appeal to the Appeals Court.

Issues

1. Whether George should have been appointed a co-trustee with Beatrice; and

2. Whether the trustee abused her discretion by making the expenditures of Trust principal described above.

Discussion and Decision

With respect to George's claim that he should have been appointed a trustee, the Appeals Court noted that George failed to appeal any aspect of the jury's decision or the judge's rulings at trial; rather, he appealed only the Superior Court's failure to grant him summary judgment *before* trial. Since, however, a jury had already tried the substantive issue, the Appeals Court (quite rationally) refused to review the prior summary judgment ruling. According to the Court, "it is well established that the denials of motions for summary judgment and partial summary judgment will not be reviewed on appeal after a trial on the merits." This result would not change, the Court stated, "even if we think summary judgment should have been allowed."

With respect to George's complaint that Beatrice abused her discretion as trustee, the Appeals Court affirmed the Superior Court's grant of summary judgment against George.

Citing to Supreme Judicial Court precedent, the Court characterized the trust language authorizing payments "for the support in reasonable comfort and maintenance of [Beatrice]" as manifesting the "unequivocal intention that [her] living expenses are to be borne exclusively by the trust income and principal." If the trust had contained language such as "when in need" or "if necessary" (which it did not), the trustee would have been required to consider the beneficiary's other assets. Absent such language, however, "Beatrice was not required to use her own assets before invading the trust principal for her support."

Regarding whether the challenged transactions were reasonable, the Court stated that "reasonable comfort and maintenance is measured by reference to [Beatrice's] standard of living before she became a beneficiary of the trust." The Court was not persuaded that the payments Beatrice made were a departure from her standard of living prior to Arthur's death.

Comment

This case highlights the importance of carefully reviewing an instrument's language before making a discretionary distribution of principal. Although in this case the trustee was not required to take into account the beneficiary's personal assets in determining whether a discretionary distribution of principal was appropriate, if words such as "if necessary" or "when in need" are in included in a trust instrument, such a review is required.

Appendix

_________________, 2011

Senator / Representative ___________________
State House
Room / Suite _________
Boston, MA 02133

Dear Senator / Representative _______________________,

I am writing to ask for your support with regard to two bills: the Massachusetts Uniform Trust Code (H.3780/S.2034), which was passed by the House on November 2, 2011, and is currently before the Senate Ways and Means Committee, and a technical corrections bill which will correct certain provisions of the Massachusetts Uniform Probate Code (S.704), which is currently before the Joint Committee on the Judiciary.

These bills will go far towards modernizing trust law in Massachusetts and bringing it into conformity with the law of the growing number of states (including Connecticut, New Hampshire, Vermont and Maine) that have passed versions of the Uniform Trust Code. These bills, which have been endorsed by the Boston Bar Association, the Massachusetts Bar Association, and the Massachusetts Bankers Association, are important to ensure that Massachusetts remains competitive as a forum for trusts. They will streamline certain aspects of trust administration and probate court proceedings, reducing costs, inefficiency and uncertainty for trustees and for beneficiaries, and will ease the burden on the probate courts.

The provisions of the Massachusetts Uniform Probate Code pertaining to trusts are scheduled to come into effect on January 2, 2012. This would also be the effective date of H.3780/S.2034. If passed, H.3780/S.2034 will effectively replace the trust law provisions of the Massachusetts Uniform Probate Code. However, if passage of H.3780/S.2034 is delayed, courts, practitioners, trustees and beneficiaries will have to grapple with multiple disparate bodies of trust law in succession, unnecessarily increasing compliance costs and putting additional pressure on the courts.

In order to avoid this scenario, to provide as much time as possible to prepare for the new law, and to ensure that Massachusetts does not fall further behind in creating a modern, flexible and uniform law governing trusts, both H.3780/S.2034 and S. 704 should be passed promptly.

Therefore, I urge you to contact members of the Senate Ways and Means Committee with regards to the Massachusetts Uniform Trust Code and the Judiciary Committee with regards to the technical corrections to the Massachusetts Uniform Probate Code and ask them to report favorably on these bills. Once the bills have been reported, please vote for them. Thank you for helping to move Massachusetts trust law into the 21^{st} century.

Sincerely,

____

Working Draft Directive 11-XX: Massachusetts Basis of Property Acquired from Decedents Who Died in 2010 or Who Die in 2011 or Thereafter

Attached for public and practitioner comment is a draft Directive, Massachusetts Basis of Property Acquired from Decedents Who Died in 2010 or Who Die in 2011 or Thereafter. Federal law permits the executor of the estate of a decedent who died in 2010 to elect either "carryover" basis or "stepped-up" basis. Massachusetts law is based on the January 1, 2005 Internal Revenue Code that required "carryover" basis for property received from a decedent who died in 2010. For 2011 and thereafter, both federal basis and Massachusetts basis will be "stepped-up", which was the rule for years prior to 2010.

Please e-mail any comments to rulesandregs@dor.state.ma.us no later than Thursday, November 11, 2011.

WORKING DRAFT FOR PRACTITIONER COMMENT - 10/11/11

Income Tax
Directive 11-XX

Massachusetts Basis of Property Acquired from Decedents Who Died in 2010 or Who Die in 2011 or Thereafter

Introduction: The Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16) ("EGTRRA") made changes to the federal estate tax. It provided for the elimination of the federal estate tax for the estates of decedents dying in 2010 and the reestablishment of the federal estate tax system as provided for in the law that existed prior to the enactment of EGTRRA for the estates of decedents dying in 2011 or thereafter. EGTRRA also made changes to the basis of property acquired from decedents. For decedents who died in 2010, the property generally would have a "carryover" basis, as increased by the amounts discussed below, and for decedents who died in 2011 or thereafter, the property would have a "stepped-up" basis which is the method of basis determination for property received from decedents who died prior to the "carryover" system established by EGTRRA for 2010 only.

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312) ("TRUIRJCA") retroactively reinstated the federal estate tax, applicable to the estates of decedents who died in 2010 and thereafter, with provisions that are different from the EGTRRA law and reinstituted "stepped-up" basis for property acquired from decedents who died in 2010. TRUIRJCA permits the executor of the estate of a decedent who died in 2010 to elect out of the federal estate tax and the "stepped-up" basis treatment for 2010 and instead use the "carryover" basis provided for by EGTRRA in the Internal Revenue Code ("Code") under § 1022(a) and the allowable basis increases of § 1022(b) and (c).

If the executor elects "carryover" basis, the basis can be increased by an aggregate amount, applicable to any estate, of up to $1,300,000. A further basis increase of up to $3,000,000 is available for qualified spousal property. The qualified spousal property increase of up to $3,000,000 is in addition to the increase of up to $1,300,000 that is applicable to any estate. For property acquired from decedents who die in 2011 or thereafter, the federal basis is "stepped-up".

As discussed below, the January 1, 2005 Internal Revenue Code is applicable for Massachusetts income tax purposes for 2010 and 2011. The changes made by EGTRRA were part of the January 1, 2005 Code and are used to determine Massachusetts basis. TRUIRJCA was enacted in 2010 and was not part of the Code on January 1, 2005.

Issue 1: What is the Massachusetts basis of property acquired from decedents who died in 2010?

Directive 1: The Massachusetts basis of property acquired from decedents who died in 2010 is the basis computed using I.R.C. § 1022 which is "carryover" basis. Unlike federal law, "carryover" basis is mandatory in Massachusetts and is not an election made by the executor of a decedent's estate. The carryover basis can be increased by an aggregate amount of up to $1,300,000, applicable to any estate, and an additional basis increase of up to $3,000,000 for qualified spousal property.

Issue 2: What is the Massachusetts basis of property acquired from decedents who die in 2011 or thereafter?

Directive 2: The Massachusetts basis of property acquired from decedents who die in 2011 or thereafter is the basis computed using I.R.C. § 1014 which is "stepped-up" basis.

Discussion of Law: G.L. c. 62, § 1(c) provides that, for the taxation of incomes for tax years ending on or after January 1, 2005, the term "Code" means, with certain exceptions not relevant here, the Internal Revenue Code of the United States, as amended on January 1, 2005 and in effect for the taxable year. St. 2009, c. 27, s. 151. EGTRRA was enacted in 2001 and was part of the January 1, 2005 Code. Historically, the basis of property acquired from a decedent was determined by G.L. c. 62, § 6F(b)(2)(C) that provides, in part, "in the case of property acquired from a decedent within the meaning of section one thousand and fourteen (b) of the Code, the initial basis of such property shall be determined under section one thousand and fourteen of the Code, without reference to section one thousand and fourteen (d) of the Code." The § 1014(a) basis of property acquired from a decedent is frequently referred to as the "stepped-up" basis and is applicable to 2009 and before and to 2011 and thereafter.[1]

Property Acquired From Decedents Who Died in 2010: EGTRRA added Code § 1014(f) that repealed the "stepped-up" basis provisions of § 1014 only with respect to property acquired from decedents who died in 2010. Code § 1022, which was also added by EGTRRA and is applicable for Massachusetts purposes, governs property acquired from a decedent who died in 2010. P.L. 107-16, § 542(a). Section 1022(a) provides that property acquired from a decedent who died in 2010 is treated as a gift and will have "carryover" basis.

For property acquired from a decedent who died in 2010, section 1022(b) provides for an aggregate basis increase, applicable to any estate, of up to $1,300,000. A further basis increase of up to $3,000,000 for qualified spousal property is provided for in § 1022(c). The aggregate qualified spousal property increase of up to $3,000,000 is in addition to the increase of up to $1,300,000 that is available to any estate.[2]

For federal purposes, the executors of estates of decedents who died in 2010 electing "carryover" basis must file Form 8939, Allocation of Increase in Basis for Property Acquired from a Decedent, with the Internal Revenue Service on or before January 17, 2012. There is no similar requirement for filing with the Department of Revenue.

Property Acquired From Decedents Who Die in 2011 or Thereafter: The basis of property acquired from decedents who die in 2011 or thereafter is "stepped-up" basis.

WORKING DRAFT FOR PRACTITIONER COMMENT - 10/11/11

[1] For both Massachusetts and federal income tax purposes, the basis of property is "stepped-down" if the estate value is less than the decedent's basis.

[2] For Massachusetts estate tax purposes, the usual valuation rules, *e.g.*, date of death value, the alternate valuation date value, apply to property acquired from decedents who died in 2010.

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November 21, 2011

Stanley Greenwood, Tax Counsel
Massachusetts Department of Revenue
Rulings and Regulations Bureau
100 Cambridge Street - 7th Floor
Boston, Massachusetts 02114

Re: <u>Comments on the Draft Directive, "Massachusetts Basis of Property Acquired from Decedents Who Died in 2010 or Who Die in 2011 or Thereafter"</u>

Dear Mr. Greenwood:

On behalf of the Boston Bar Association, I thank you for the opportunity to submit comments on the Department of Revenue's draft directive, "Massachusetts Basis of Property Acquired from Decedents Who Died in 2010 or Who Die in 2011 or Thereafter." The Boston Bar Association's Trusts and Estates Section, a group of attorneys with professional expertise in probate and trust issues, has reviewed the draft directive and prepared the enclosed comments.

As you know, Massachusetts did not alter its rules on property inherited from a decedent in the wake of federal action that abolished the "step-up" in basis for all inherited property in 2010. In light of that fact, the BBA Council, which is the Association's governing body, voted in June 2010 to approve the filing of proposed state legislation designed to remedy the resulting double taxation issue. This legislation, H 2559, "*An Act to continue tax basis rules for property acquired from decedents,*" is currently being reviewed by the Joint Committee on Revenue. The enclosed comments of the BBA's Trusts & Estates Section on the Department of Revenue's draft directive are consistent with the provisions of this legislative proposal.

We hope that the enclosed comments will be of assistance to the Department of Revenue. Please feel free to contact me at my office at (617) 619-3428 if the BBA or I can be of any additional assistance.

Sincerely,

Lisa C. Goodheart

Lisa C. Goodheart
President

Enclosure
cc: Marc J. Bloostein, Esq., Co-Chair, BBA Trust & Estates Section
Chris Perry, Esq., Co-Chair, BBA Trust & Estates Section

NOVEMBER 2011 COMMENTS OF THE BOSTON BAR ASSOCIATION'S TRUSTS & ESTATES SECTION ON DRAFT DIRECTIVE ENTITLED "MASSACHUSETTS BASIS OF PROPERTY ACQUIRED FROM DECEDENTS WHO DIED IN 2010 OR WHO DIE IN 2011 OR THEREAFTER"

Over the last several decades, assets that were subject to estate tax for either federal or Massachusetts purposes were entitled to a stepped-up basis when inherited. Although federal rules would have abolished the estate tax and implemented carryover basis for inherited property, Massachusetts did not similarly abolish its estate tax. However, the Department of Revenue's draft Directive concludes that assets inherited from a decedent who died in 2010, and which were subject to Massachusetts estate tax, would not qualify for stepped-up basis and would instead have a carryover basis for Massachusetts tax purposes.

We believe that the Directive should conclude that assets inherited from a decedent who died in 2010 should qualify for stepped-up basis for Massachusetts tax purposes because: (i) federal carry-over basis rules are treated as having never been enacted and therefore are not applicable for Massachusetts purposes, (ii) in the alternative, the rule that would make a basis step-up inapplicable for federal purposes should not be applicable for Massachusetts purposes; and (iii) applying carry-over basis to assets inherited from decedent's dying in 2010 could have the effect of double taxation.

Alternatively, if, after further consideration, the DOR still concludes that assets inherited from a decedent who died in 2010 would not qualify for stepped-up basis and would instead have a carryover basis for Massachusetts tax purposes, we believe that the Directive should be prospective and only apply to transactions that occur in taxable years beginning after the date that the Directive is released as final.

A. Step-up in Basis for Assets Inherited From a Decedent In 2010

Massachusetts General Laws c. 62, §6F provides that the basis of property inherited from a decedent shall be "determined under" §1014 of the "Code". For purposes of M.G.L c. 62, §6F references to Code mean "the Internal Revenue Code of the United States, as amended on January 1, 2005 and in effect for the taxable year".[1]

The general rule of §1014 is that the basis of property inherited from a decedent is the date of death fair market value of such property – stepped-up basis.

Section 1014(f) of the Code was added to the Code pursuant to §541 of the Economic Growth and Tax Relief and Recovery Act[2] ("EGTRRA"). Section 1014(f) provided that §1014 "shall not apply with respect to decedents dying after December 31, 2009." Section 1014(f) is commonly understood as having been introduced so that §1014 stepped-up basis for property inherited from a decedent would be replaced with carryover basis for such property pursuant to §1022 of the Code, also added by EGTRRA. The substitution of carryover basis for stepped-up basis had the

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[1] M.G. L. c. 62, §1(c).

[2] P.L. No. 107-16, 115 Stat. 38, June 7, 2001.

effect of introducing new federal income tax revenue to offset the decrease in revenue resulting from the repeal of the federal estate tax beginning after 2009.

While it might appear that the presence of §§1014(f) and 1022 could lead to a result that would make §1014 inapplicable for the purpose of determining basis of property inherited from a 2010 decedent, we believe that §§1014(f) and 1022 should not be applicable for Massachusetts tax purposes.

1. <u>Sections 1014(f) and 1022 were not part of the Code as amended on January 1, 2005.</u>

The Code sections providing for carry-over basis in place of stepped-up basis were not part of the Code as amended on January 1, 2005 because they are treated as having never been enacted.

As noted above, §§1014(f) and 1022 were added to the Code in 2001 pursuant to EGTRRA §§541 and 542. However, by reason of §301(a) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010[3] ("TRUIJCA"), the subtitle of EGTRRA containing §§541 and 542 was "amended to read as such provision would read if such subtitle <u>had never been enacted</u>" (emphasis added).[4]

Massachusetts General Laws c. 62, §1(c) would seem to prevent amendments to the January 1, 2005 version of the Code from being considered for Massachusetts purposes. However, TRUIJCA §301 did not amend the Code, it amended EGTRRA §§541 and 542. Moreover, TRUIJCA §301 did not merely change the terms of EGTRRA §§541 and 542, rather, it treated those sections of EGTRRA <u>as having never been enacted</u>. As a result, the law that would have added §§1014(f) and 1022 to the Code in 2010 was in effect never enacted in 2001, and thus those sections were never contained in "the Internal Revenue Code of the United States, as amended on January 1, 2005".[5]

Furthermore, despite the long precedent recognizing that federal tax laws may be retroactive, the language of M.G. L. c.62, §1(c) that ties references to the Code to "the Internal Revenue Code of the United States, as amended on January 1, 2005" does not preclude retroactive laws that would have the effect of treating certain provisions of the Code as having never been enacted prior to January 1, 2005.[6] Accordingly, the retroactive law treating §§541 and 542 of EGTRRA as having never been enacted in 2001 would mean that the §§1014(f) and 1022 were never added to the Code for Massachusetts purposes.

[3] P.L. 111-312, 124 Stat. 3296, December 17, 2010.
[4] *Id.*
[5] TRUIJCA §301 contains an effective date of December 31, 2009 "except as otherwise provided". Section 301(a) was fully retroactive to the enactment date of EGTRRA §§541 and 542 in 2001. Moreover, Massachusetts's Code reference ties to the Code "in effect for the taxable year." If the effective date provision of §301 is meant to apply to §301(a), then seemingly the effective date provision makes §301(a) a provision of the Code that is in effect for the taxable year.
[6] *See*, <u>Hanscom v. Malden & Melrose Gas Light Co.</u>, 220 Mass. 1, 3 (1914) (citing the general rule of statutory interpretation that "all statutes are prospective in their operation, unless an intention that they shall be retrospective appears by necessary implication from their words, context or objects when considered in the light of the subject matter, the pre-existing state of the law and the effect upon existent rights, remedies and obligations.") *See*, <u>Stockdale v. The Insurance Companies</u>, 20 Wall. 323(S. Ct. 1873) (enactment of a retroactive tax law was within the power of Congress). *See also*, <u>U.S. v. Carlton</u>, 512 U.S. 26, 30 (1994) (reviewing the long precedent of retroactive federal tax laws).

2. Section 1014(f) is not a basis determination rule.

M.G. L. c. 62, §6F provides that the basis of property inherited from a decedent shall be "determined under" §1014. The general rule of §1014 is that property inherited from a decedent takes a stepped-up basis. Massachusetts law does not contain the operational mechanics for determining stepped-up basis but instead relies on §1014 to provide those mechanics. Provisions contained in §1014 that do not provide mechanics for determining stepped-up basis should not apply for Massachusetts purposes.

Section 1014 provides a variety of detailed rules relative to determining stepped-up basis, including: (a) the value of the property to be used and the effect of related tax elections, (b) the circumstances under which property is treated as inherited from a decedent; and (c) certain types of inherited property that do not qualify under the general rule. The mechanics and detailed rules for determining stepped-up basis under §1014 have been relied upon by Massachusetts for decades. [7]

In 2001, §1014(f) was added to the Code pursuant to EGTRRA §541. §1014(f) provided that §1014 "shall not apply with respect to decedents dying after December 31, 2009." Unlike the other provisions of §1014, §1014(f) contains no rules relative to the determination of stepped-up basis. Instead, §1014(f) is a procedural rule that would have solely facilitated the exchange of the §1014 basis step-up rules for the §1022 carryover basis rules with respect to property inherited from a decedent dying after December 31, 2009.

If, despite the analysis to the contrary outlined in item 1 above, §1014(f) is viewed as being included in §1014 for Massachusetts purposes, §1014(f) should nevertheless not be given any effect since §1014(f) is not itself part of the mechanics for determining the stepped-up basis for property acquired from a decedent as specifically provided in M.G. L. c. 62, §6F. To give §1014(f) any effect would be in opposition to the specific reference in Massachusetts law that property inherited from a decedent is to be determined under the basis step-up rules of §1014.

Moreover, unlike the §1014 basis step-up, the §1022 carryover basis that the DOR has concluded would be applicable to property inherited from decedents dying in 2010 is not specifically provided for under Massachusetts law as being applicable for determining the basis of property inherited from a decedent.

Massachusetts has a long history of conferring a basis step-up on property that was subject to estate tax. [8] Because the Massachusetts estate tax remains in place, the basis step-up should likewise continue. In keeping with this system of law, the Appeals Court has recognized that to the extent property is subject to estate tax for Massachusetts purposes, such property should receive a step-up in basis in accordance with M.G. L. c. 62, §6F, notwithstanding that literal application of the federal basis rules could have produced a different result. [9] In contrast, reading

[7] *See* Massachusetts Department of Revenue ("DOR") Technical Information Release 88-7 (July 5, 1988) (setting forth the mechanics for determining basis of property with reference to various provisions in the Code).

[8] *See*, Minkin v. Commissioner, 425 Mass. 174 (1997) (stating that a beneficiary would have been entitled to a step-up in basis had she sold shares inherited from a decedent). *See also*, Treat v. Commissioner, 52 Mass.App.Ct. 208 (2001) (stating that where property is acquired from a decedent, the taxpayer's adjusted basis is the fair market value at the time of death).

[9] Treat, 52 Mass. App. Ct. at 212-13.

§1014(f) as making a basis step-up inapplicable to property inherited from a decedent who died in 2010 would deny a basis step-up to property subject to estate tax for Massachusetts purposes.

3. Giving no effect to §§1014(f) and 1022 would avoid the possibility of double taxation.

Construing M.G.L. c. 62, §6F to mean that property inherited from a decedent dying in 2010 has a carryover basis would effectively result in such property being subject to estate tax and continued capital gains tax on the property's pre death appreciation that had already been subject to estate tax. We could find no Massachusetts tax law precedent in recent decades that treated property inherited from a decedent as being subject to estate tax and continued capital gains tax, nor would such treatment result under the DOR's reading of the law for years after 2010.[10]

Although the DOR's reading of the law for 2010 might not give rise to literal double taxation because taxation would occur under different taxing regimes (estate tax and income tax), the Supreme Judicial Court has recognized that situations that are "...tantamount to double taxation... should be avoided."[11] In that case the Supreme Judicial Court agreed with the Appellate Tax Board's finding that an interpretation of a tax law which had the result of applying two levels of tax to the same receipts (albeit in the hands different taxpayers) was inconsistent with the intention of the legislature for there to be one level of tax.[12]

The long history of a step-up in basis applying to property subject to estate tax,[13] coupled with the fact that the Massachusetts legislature has not explicitly modified Massachusetts's own basis step-up rule to prevent its application to property inherited from a 2010 decedent, suggests that an interpretation of M.G.L. c. 62, §6F to mean that property inherited from a decedent dying in 2010 takes a carryover basis could be viewed as "...tantamount to double taxation..." and "...should be avoided." Such an interpretation stands in contrast to the longstanding understanding that, in general, property subject to estate tax is entitled to a step-up in income tax basis.

B. Prospective Application of the Directive

If, after further consideration, the DOR concludes that assets inherited from a decedent who died in 2010 would not qualify for stepped-up basis and would instead have a carryover basis for Massachusetts tax purposes, we request that the Directive provide for prospective application only to transactions that occur in taxable years beginning after the date that the Directive is released as final.

A DOR Directive may generally be applied prospectively only. Massachusetts General Laws c. 62C, §26(j)(1) provides that "no assessment based on a change in policy shall be made with respect to taxable years or periods that began prior to the issuance of a public written statement" describing the changes.

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[10] *See* Working Draft Directive 11-XX: Massachusetts Basis of Property Acquired from Decedents Who Died in 2010 or Who Die in 2011 or Thereafter, released October 11, 2011 (providing that, consistent with federal rules, for 2011 and thereafter, Massachusetts basis of property inherited from a decedent would be the value of such property as of the decedent's date of death, which was the rule for years prior to 2010).

[11] Commissioner of Revenue v. Shafner, 392 Mass. 256, 261(1984).

[12] *Id.; see also,* Shafner v. Department of Revenue, 2 Mass. App. Tax. Bd. Rep. 166, 170 (1983).

[13] *See* Treat, 52 Mass. App. Ct. at 211.

A DOR Directive would be considered a change in tax policy where it contains an "interpretation of a rule of law" and does not merely apply established law to a particular transaction.[14]

We believe that the Directive would be considered a change in policy because it interprets the interplay between M.G. L. c. 62, §6F and various federal tax rules and does not merely apply a previously announced or established rule of law to the facts and circumstances of a particular transaction.

Presumably, taxpayers have sold property inherited from decedents who died in 2010 under the understanding that such property was entitled to a stepped-up basis under §1014 as it has historically existed for property subject to estate tax in Massachusetts. Those taxpayers would have made those sales without any knowledge that the DOR would reach a conclusion that property inherited from a decedent dying in 2010 would have a carryover basis. As such, the Directive could affect transactions that have already occurred.

The Appellate Tax Board ("ATB") and the Supreme Judicial Court have expressed reservations about DOR policies adopted with retroactive effect.[15]

Therefore, we request that the DOR provide affirmative guidance to taxpayers that the Directive will only apply to transactions occurring in tax years beginning after the date that the Directive is released as final and not to transactions that occurred in tax years beginning before that date.

[14] M.G.L c. 62C §26(j)(2).

[15] Shafner v. Department of Revenue, 2 Mass. App. Tax. Bd. Rep. 166, 170 (1983), aff'd 392 Mass. 256 (1984); Comm'r of Revenue v. Baybank Middlesex, 421 Mass. 736,742-3 (1996).