Recent Developments Affecting Estate Planning

Stanley M. Johanson

University Distinguished Teaching Professor and
James A. Elkins Centennial Chair in Law
The University of Texas School of Law
Austin, Texas

Probate, Trusts and Estates Section

Dallas Bar Association

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A. **At last! We finally know where we stand regarding the estate and gift tax—for the next two years.** On December 17, 2010, President Obama signed a tax bill whose "short title" is the "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010." (How's that for a short title?) The Act, certain to be known by its acronym, TRUIRJCA, is referred to herein as TRA 2010. TRA 2010 generally provides that the tax provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (the "Bush tax bill") are extended through 2010.

1. **"I'll be baaack."** (And where is the Terminator when we need him?) **All of TRA 2010's tax provisions expire on December 31, 2012**. On January 1, 2013, the law as it existed in 2001, including a $1,000,000 estate tax and gift tax exemption equivalent and estate tax rates than can reach 55 percent, will arise like Phoenix from the ashes—or from a molten puddle, like that relentless "policeman" in Terminator II.

   a. But surely Congress will do address the situation and give a "permanent" solution regarding transfer taxes long before the end of 2012!

   b. The problem is, that was the universal (I didn't say near-universal; I said *universal*) consensus after the Bush tax bill was enacted in 2001: *Surely* Congress would do something by the end of 2009! Well, they didn't (and don't call me Shirley).

2. **There is more than a likelihood that Congress will do *nothing* about transfer taxes until the next lame duck session.** Consider the political situation. The Republicans control the House of Representatives, and are likely to want (among other things) to make the $5 million exemption equivalent permanent—which is about as close to total repeal of the estate tax as you can get. The Repubs, who for sure do *not* want to see a $1 million exemption equivalent on January 1, 2013, will certainly have their way in the House.

   a. However, the Democrats control the Senate (51 Dems plus Bernie Sanders from Vermont plus Joe Lieberman from Connecticut), and more than a few of them believe that Mr. Obama gave up 'way too much in exchange for getting a 13-week extension of unemployment benefits and a nuke agreement. Can we expect the Senate—at least as it is constituted before the November 2012 election—to go along with any form of relief regarding transfer taxes unless there is some not-yet-identified bargaining chip that works in their favor?

      And if the federal deficit continues to loom large, won't the projected revenue from a "mere" $1 million exemption equivalent look rather appealing?

   b. But the Democratic Senate is in pretty much the same fix when it comes to any proposals to tightening the transfer tax rules. Consider some of the items that were either in the Obama administration's fiscal year 2012 budget proposal (published February 14, 2011) or on the Joint Committee on Taxation's wish list: limit valuation discounts to active businesses, replace the willing buyer-willing seller test with family attribution rules, kill off short-term GRATs, etc. Any attempt to tighten the estate & gift tax rules is highly unlikely to even get *on* the launching pad in the Senate.

   c. The estate tax (whether it is seen as a "death tax" or "a give-away to the wealthy") could well be an issue in the 2012 presidential campaign.

d. There is one topic that could well get bipartisan support: Spousal portability, discussed below. Several Democrat-sponsored bills introduced in 2009 and early 2010, and Sen. Max Baucus's Senate Finance bill introduced in early December, included this provision. However, that bipartisan spirit applied to much lower exemption levels. Can we expect that same spirit to exist when the effect will be to give the surviving spouse an exemption equivalent of as much as $10 million?

3. **Bottom line: There is only one thing that is certain: more uncertainty for at *least* the next two years.** This will be a continuing concern for clients and their attorneys.

   Wait a minute! Did I say "and their attorneys"??? The moment I typed that, I thought of Alfred E. Neuman, of Mad Magazine fame: "What, me worry?" for the foreseeable future, estate planning attorneys and CPAs are going to pretty busy the next two years.

B. Exemption equivalent increased to $5 million under estate tax, gift tax, and generation-skipping transfer tax. For estates of decedents dying in 2010, the estate tax (and GST) exemption equivalent is $5 million and the maximum transfer tax rate is 35 percent. The gift tax exemption was left at $1 million for 2010, and became $5 million on January 1, 2011. The $5 million exemption amounts may even be somewhat higher in 2012, because the new law provides for a cost-of-living increase that year.

1. **It is important for clients to understand that for gift tax purposes, this is *not* an exemption!** This simply means that for taxable gifts (over annual exclusions) of up to $5 million, no front-end gift tax has to be paid. However, the taxable gift will come into the donor's estate tax computation as an adjusted taxable gift. If a client makes a $5,013,000 gift, with a $13,000 exclusion the client will have made a taxable gift of $5 million, which will come back in the estate tax computation as a $5 million adjusted taxable gift. If the estate tax exemption equivalent reverts back to $1 million in 2013, the estate tax will be horrific.

C. Portability of last deceased spouse's unused estate tax exemption. Several of the bills relating to the estate tax in 2009 and early 2010 included this feature, under which any unused exemption equivalent of the deceased spouse would be carried over to the surviving spouse. This provision is included in TRA 2010, but with one important change from the earlier proposals. To prevent spouse-stacking—what one CLE speaker referred to as the Larry King rule—portability of the unused estate tax exemption is limited to the unused exemption of ***the last deceased spouse***. The "deceased spouse unused exclusion amount" is the lesser of (1) the basic exclusion amount or (2) the basic exclusion amount of the surviving spouse's last deceased spouse over the combined amount of the deceased spouse's taxable estate over adjusted taxable gifts."

1. **Estate of deceased spouse must to file and make election on estate tax return**. To secure the carryover of the deceased spouse's unused exemption equivalent, the spouse's executor must file a timely (including extensions) estate tax return.

   a. As a consequence, executors of even small estates will want to consider whether to file an estate tax return for the first deceased spouse's estate—if the spouse dies in 2011 or 2012.

   b. **Statute of limitations applicable to first deceased spouse's estate remains open**. Notwithstanding any period of limitation on assessing estate or gift taxes for the predeceased spouse, the Service may examine the return of a predeceased for purposes of determining the deceased spouse's unused exclusion amount. §2010(c)(5)B). This would be after the surviving spouse's death, of course.

2. **Portability applies for gift tax purposes as well**. TRA 2010 amends §2505(a)(1) to define the "applicable credit amount" for gift tax purposes by referring to the applicable credit amount under §2010(c) "which would apply if the donor died at the end of the calendar year."

3. **No portability for unused GST exemption**. Portability applies only to any unused portion of the deceased spouse's estate tax exemption. Portability does not apply to any unused GST exemption.

4. **Planning opportunities involving "spousal rollover."** Back when the unlimited marital deduction was introduced in 1981, some CLE speakers (not always with tongue in cheek) suggested that the best estate plan for a wealthy widow was to log onto eharmony.com, and marry a younger man certain to outlive her, thereby securing a marital deduction via a QTIP election.

    a. Portability has changed all of that because the objective, now, will not be to secure a marital deduction but, instead, to secure unused estate tax exemption. That widow should log onto eharmony.com, only now she should be looking for an older man with a small estate—ideally in poor health. This will enable the widow to effectively increase her estate tax exemption to $10 million.

    b. **Divorce and two remarriages in contemplation of death?** Let's take this a step further. H and W, happily married for 40 years, have each accumulated wealth of $10 million, and want to pass as much as they can via dynastic trusts for their children. Good tax planning strongly suggests that they divorce each other (one of them spending six weeks in Reno or Las Vegas if time is short), and then each should marry an elderly, sickly and impecunious bride or groom. With portability, they'll each have up to $10 million in estate tax exemption!

    c. **An even better plan**. Even better, the widow may want to … OK; I'll quit. I think I've carried this far enough.

4. **Effective date: Both spouses must die after 2010 and before 2013**. The portability provision disappears along with the rest of TRA 2010 at the end of 2012. As a consequence, it is not enough for the first deceased spouse to die in 2011 or 2012; both spouses must die within that two-year period—unless Congress extends the rule into future years.

    a. This makes planning in reliance on the portability provision problematic, to say the least. Consider the couple with an $8 million community estate. If the first deceased spouse (H) leaves his community share in a form that qualifies for the marital deduction (*e.g*, a QTIPable trust), he would not utilize any of his credit shelter, and portability would leave W with a total of $8 million in exemption equivalent—but only if W dies before 2013 or Congress has extended the portability rule.

    b. In most situations, it probably would be a better idea for the clients to utilize a standard bypass trust plan: there is no assurance that portability will apply after 2012; portability is lost if the surviving spouse remarries and survives his or her next spouse; there is no portability of the GST exemption; and there will be all the benefits of a trust settlement.

5. What are the chances of the portability provision being made permanent?

    a. At first blush, chances would appear to be pretty good. Nearly every bill introduced in 2009 and early 2010 contained a portability provision—including several bills introduced by Democrat senators and representatives. The portability idea has support on both sides of the aisle.

b. On the other hand, if the estate tax exemption equivalent remains at $5 million, there may be some queasiness on the Democratic side of the aisle in going along with portability at that level.

c. The Obama administration fiscal year 2012 budget proposal, published on February 14, 2011 ("the Greenbook"), recommends making portability permanent. It begins discussion of the idea, though, by noting that TRA 2010 increased the exemption equivalent to $5 million. "However, after 2011, the amount of this exclusion is scheduled to revert to the amount that would have been in effect had [EGTRRA] never been enacted (thus, $1 million)."

D. These provisions were not enacted. Three significant transfer tax proposals, included in some of bills that were introduced in 2009 and 2010, are *not* part of TRA 2010. However they *are* included once again in the Obama administration's fiscal year 2012 budget proposal.

1. **GRATs are still with us**. The Obama Administration budget proposal includes a provision that would kill off short-term grantor retained annuity trusts [*cf. Walton v. Commissioner*, 115 T.C. 589 (2000)] by requiring a 10-year minimum GRAT term, requiring that the GRAT remainder interest must have a value greater than zero, and providing that the amount of the annuity payout could not be decreased during the GRAT term. TRA 2010 makes no mention of GRATs.

2. **Provide reporting on a consistent basis between estate tax valuation and income tax basis in the heir's hands.** Under §1014, assets receive a new basis, for income tax purposes, equal to their date-of-death value. The value of property as reported on the decedent's estate tax return raises a rebuttable presumption of the property's basis in the hands of the heir—but more than a few heirs have successfully rebutted that presumption. For estate tax purposes, the executor may take a low valuation to reduce estate tax, yet the heir would prefer a higher basis for income tax purposes. As the Obama Administration 2011 budget proposal puts it, "[t]his proposal would require that the basis of the property in the hands of the recipient be no greater than the value of that property as determined for estate or gift tax purposes." No such provision appears in TRA 2010.

3. **Valuation discounts—amendments to §2704.** The Obama administration's 2012 budget proposal once again recommends amending §2704 (the "disappearing rights and restrictions" special valuation rule). The statute as amended would add a new category of "disregarded restrictions." These restrictions would be ignored for transfer tax valuation purpose in valuing an interest in a family-controlled entity (*e.g.*, a family limited partnership) that is transferred to a member of the family if, after the transfer, the restriction could be removed by the transferor or the transferor's family. No such provision appears in TRA 2010.

a. **Can we expect to see regulations, then?** Section 2704(b)(4) gives the Secretary authority to issue regulations regarding a restriction that has "the effect of reducing the value of the transferred interest for purposes of this subtitle, but does not ultimately reduce the value of such interest to the transferee." For the past six years, (beginning in 2003-2004), the Priority Guidance Plan has included "guidance under §2704 regarding restrictions on the liquidation of an interest in a corporation or partnership." At the Fall 2008 ACTEC meeting, Cathy Hughes, of Treasury's Office of Tax Policy, said that work on such regulations is "at the top of the list," and that regulations would likely be issued by the end of the year. Needless to say, that did not happen. At an ABA meeting in September 2009, Hughes indicated that the regulations were ready to be published, but were being held back pending possible by Congress.

b. Well, Congress did not amend §2704. Will we see the proposed regulations, then? Time will tell.

E. **Limit GST-exempt trusts to 90 years?** The Obama administration budget proposal published on February 14, 2011, contained a new provision that was not part of last year's budget proposal. The Greenbook notes that many states have either repealed or limited the application of the rule against perpetuities. "As a result, the transfer tax shield provided by the GST exemption effectively has been expanded from trusts funded with $1 million and a maximum duration limited by the RAP, to trusts funded with $5 million and continuing (and growing) in perpetuity." Under this proposal, the duration of a GST exemption would expire after 90 years.

3. Where did the get the 90-year idea? That is the alternate vesting period under the Uniform Statutory Against Perpetuities, which has been enacted in several states.

F. **Planning implications are enormous.** In view of a $5 million exemption under the estate tax, gift tax and GST, it's a whole new world. For the vast majority of clients, the estate, gift and GST taxes have been functionally repealed.

1. **Up to $5 million ($10 million if married) can be given with no front-end gift tax.** Clients can transfer as much as they would like to their descendants, removing future appreciation from the transfer tax base, with no front-end gift tax cost. If settled in a dynastic trust, $5 million (or $10 million) of GST exemption can be allocated to the trust, effectively removing the property from the transfer system forever (or virtually forever).

2. **The $5 million (or 10 million) exemption can be leveraged with traditional planning tools,** such as family limited partnerships, LLC,s gifts of fractional interests, etc.

3. **More substantial funding with respect to installment sales to defective grantor trusts**. There has always been a concern that unless that grantor trust is funded with assets having a value of at least 10 percent of the value of the asset to be sold to the trust, the trust may not be recognized and the transaction may be treated as a sham. But now, Client could transfer assets worth $5 million to the trust with no front-end gift tax cost, and then sell $50 million of assets on an installment note with a very low interest rate. If the grantor pays the tax on trust income without reimbursement, his estate is further depleted by the "tax burn."

a. Because of the ability to allocate GST exemption to a grantor trust, in most instances a DIGIT likely to be far more attractive than a transfer to a GRAT.

4. **Virtually no cap on life insurance trusts.** Until now, there has been essentially a cap on how much can be transferred to an ILIT to cover future premium payments without gift tax consequences—the former $1 million gift tax exemption was the cap. That cap has been essentially removed. With $5 million (or $10 million) gift tax exemption, an extraordinary amount of life insurance can be acquired, to pass to the children and more remote descendants free of tax.

a. **Why play the Crummey withdrawal power game?** The Crummey withdrawal power is a good way to secure annual exclusions for future premium payments, but it involves an ongoing hassle, especially if the policy is so substantial that we have to worry about "hanging powers." It also precludes or caps annual exclusion gifts of other assets to that beneficiary. Why not, instead, initially fund the trust with (say) $2 million—with no front end gift tax cost? The $2 million could be used either to acquire a rather whopping single-premium policy or as trust fund to cover future premiums. In the latter situation, the trust would be a grantor trust, meaning that all income would be taxed to the grantor, but a grantor who might be interested in this transaction would not likely care.

b. **"Maybe I don't need all of that life insurance."** Some clients (even clients with a "mere" $3 to $5 million estate) may be thinking about dropping their coverage, or cease making addition to an ILIT to cover future premiums because a primary motive in setting up the ILIT was to cover estate taxes that are no longer a concern. ***Mistake!*** (1) If circumstances change and client ends up needing life insurance after all, he may no longer be insurable. (2) We know what the transfer tax system is for 2011 and 2012, but anyone who attempts to predict what the situation will be in 2013 and thereafter is a damned fool.

G. Three categories of clients: Estate planning professionals will see their clients falling into one of three categories (and I am broadly oversimplifying here): (1) Mega-wealthy (over $10 million) clients for whom sophisticated estate planning continues to be called for; (2) couples in the $5 to $8 million range, for whom transfer taxes may or may not be a concern down the road, and (3) modest estates—say, a married couple with an estate of "only" $5 million or less.

1. **Bypass trusts for spouses remain important**. For a couple in their 40s—or 50s, or 60s, or70s, so-called bypass trust continue to be important even if there are no estate taxes to bypass. It must be conceded that clients like two page wills: "to my [spouse] if he survives me, otherwise to my children in equal shares."

a. A major concern is that if the surviving spouse later becomes incapacitated, the result will be a costly and cumbersome guardianship administration. If instead the estate was left in trust—with the spouse serving as trustee for as long as she is able and so inclined—a guardianship administration will be avoided.

b. A trust settlement assures that the remainder interest on the spouse's death will pass to the children, rather than to that dreaded second husband.

2. **"Bypass trusts" for the children**. Another problem with that two-page will: If the children may succeed to more than a modest amount, there are very real advantages in creating trusts for the children's benefit rather than giving them outright ownership (*i.e.*, ownership free of a trust). And, each child can be the trustee of his or her own trust, giving the child the power to make management and investment decisions (just like an outright owner would make) while also giving various advantages.

a.. **Covering the contingency of divorce**. Today, over one-half of all marriages end in divorce. In Texas, only community property is subject to equitable division ("just and right" division) in a divorce proceeding. The judge cannot divest one spouse of his or her separate property and award it to the other spouse. If you property is bequeathed outright to a child, it is the child's separate property because acquired by gift, devise or descent. However, under Texas law all property on hand at the time of divorce (or death) is presumptively community property. To keep its separate property status, the property cannot be commingled with community property, and good records must be kept; otherwise it may not be possible to establish separate ownership so as to overcome the community presumption by the required "clear and convincing" evidence.

A trust (even one with the child as trustee) is a useful vehicle for segregating and maintaining managing separate property separately.

b. **Creditor protection**. If the child is in a profession or line of work in which malpractice suits are a concern (and, in today's litigious society, that includes just about everybody!), property left to a child in a trust can be given spendthrift protection, meaning that no creditors can reach the child's interest in the trust—even if the child declares bankruptcy.

c. **Protection from in-law's bad business deals**. Even if the child's marriage is solid and the likelihood of divorce is remote, parents may be concerned that the child's spouse might take some action that puts the child's inheritance at risk. (Several Texas lawyers have told me that, in explaining the pros and cons of trusts for clients' children, this is the scenario that really catches the clients' attention.)

Example 1: Donna, having inherited $750,000 from her parent's estate, carefully places the inherited funds in a Paine Webber investment account. Donna has the account titled in her name as her "sole and separate property," to segregate the assets from her and her husband Steve's other assets. Donna and Steve have been married five years, their marriage is solid, and they have a young child. Steve has decided to start a business, and has negotiated a $575,000 loan from First State Bank. Steve tells Donna that the bank won't make the loan unless Donna co-signs the note (or, perhaps, unless the loan is secured by Donna's Paine Webber account), and Steve asks her to co-sign.

Stop the camcorder! What is Donna going to tell Steve? "Sorry, Steve; I know this is important to you, but I'm not going to help you out by signing the note"? It's fair to say that Donna is in a rather dicey situation—as is her inheritance.

Need I continue the story? Donna co-signs the note. A year later, Steve's business folds after the borrowed funds have been expended in leasing an office and purchasing supplies. Donna, having co-signed the note, is personally liable. There goes Donna's inheritance.

Example 2: Same facts, except that the $750,000 that Donna inherited was left in a trust of which Donna is the trustee. The trust contains a spendthrift clause. Again, Donna co-signs Steve's note. She is personally liable on the obligation, but the trust assets cannot be reached because of the spendthrift clause.

Example 3: Same facts as in Example 2, except that Steve, instead of attempting to borrow money from the bank, asks Donna, as trustee, to either (i) loan the funds to Steve or (ii) invest trust funds in his business. Here, Donna has no choice but to point out that, in view of her fiduciary duties as a trustee, (i) a loan to a relative would constitute impermissible self-dealing, and (ii) investing trust funds in a start-up company would be an imprudent investment not within the "prudent investor" standard.

d.. **Avoids guardianship** should the child, years from now, lose her capacity.

H. What should we be telling past clients? For many former clients, Congress has just changed their wills! Consider the couple with standard A Trust/B Trust wills: a formula gift to the spouse that produces "the smallest marital deduction (and thus the largest taxable estate) that will result in no federal estate tax being payable by my estate," with a residuary gift that passes to a bypass trust. If the decedent's estate is less than $5 million, the smallest marital deduction needed to eliminate estate tax will be zero. ***For any will or trust with a marital deduction formula clause, Congress has radically changed the dispositive plan***.

1. In 1981, Congress enacted the unlimited marital deduction, at a time when formula clauses made a gift of "the largest marital deduction available to my estate." Congress also enacted a transitional rule, under which marital deduction formula clauses in wills executed were construed under the former "one-half the adjusted gross estate" rule. Under the 2010 Act, however, t***here is no transitional rule!***

2. If we are dealing with the traditional nuclear family (*e.g*., Ward and June Cleaver and Wally and Beaver), this may not be a concern. But if they have different natural beneficiaries, there could be real problems. I think it is important to ***contact those former clients!*** Their estate plans should be reexamined. You will be doing them a service! (And you'll be doing them a service when you contact them again at the end of 2012!)

3 **And what are states doing about all of this?** As of August 1, 16 states and the District of Columbia (up from nine states on May 1) had passed statutes protecting beneficiaries from the unintended consequences of the federal estate tax repeal: Delaware, District of Columbia, Georgia, Idaho, Indiana, Maryland, Nebraska, South Dakota, Tennessee, Utah, Virginia and Washington. Most of these laws interpret certain formula clauses in testamentary documents for decedents dying in 2010 as though they refer to the estate tax laws of 2009. However, the Florida and South Carolina laws simply permit the personal representatives, trustees and beneficiaries to bring an action to determine the decedent's intent when the estate planning document contains a formula based on the transfer tax laws.

II. Section 401—Qualified Plans and IRAs

A. Whose life expectancy do you use to calculate RMDs when the designated beneficiary murdered the participant? In Ltr. Rul 201008049, P named B as designated beneficiary of two IRAs. B was convicted of murdering P, and under state law was barred from taking as IRA beneficiary. Instead, alternate beneficiary A became entitled to IRA distributions. After appeals, the conviction became final eight years after P's death. Although state law treated B as having predeceased P, the Service ruled that that this did not have the effect of retroactively removing B as the designated beneficiary. As B was the designated beneficiary on the date of P's death, and as of September 30 of the calendar year following P's death, B's life expectancy should be used in calculating required minimum distributions.

1. Although no distributions had been made for eight years, the Service waived the 50% excise tax imposed by §4974(a). Taxpayer A's failure to take required minimum distributions was due to reasonable cause, as court proceedings had delayed determination of the proper IRA recipient.

B. Ouch! No waiver of rollover requirements where taxpayer used wrong account number. In Ltr. Rul. 200941032, T had an IRA account and a non-IRA account at the same institution. T attempted to make a rollover into the IRA account, but in the rollover application used the account number for the non-IRA account. The Service declined to waive the 60-day IRA rollover requirement, as T failed to show how any of the factors outlined in Rev. Proc. 2003-16, 2003-4 I.R.B. 359, prevented him from completing the rollover.

1. Waivers were granted in Ltr. Ruls. 200920061 and 200827035, but in those cases it was the institution (not the taxpayer) that had used the wrong account number.

C. Service not impressed by court-approved trust amendment designed to create designated beneficiaries. In Ltr. Rul. 201021038, D, who died after his IRA's required beginning date, had named a bypass trust created by his deceased wife as IRA beneficiary. On D's death, the trust was to be divided into two trusts and continue for two daughters' lifetimes, with the trustees authorized to make discretionary distributions to the daughters and their descendants pursuant to an ascertainable standard. Each daughter was given an inter vivos and testamentary power to appoint among a class of beneficiaries that included charities. The trust had a savings clause providing that it was intended that the trustees make appropriate elections to defer IRA distributions pursuant to the required minimum distribution rules.

1. The daughters realized that they had a problem. The trust was not a conduit trust, because the trustees were allowed to accumulate IRA distributions in the trust. The trust was not a look-through trust, because all trust beneficiaries were not individuals—the daughters had the power to appoint to a charity. The daughters obtained a court order approving a trust amendment that required the trustee to distribute all amounts received from the IRA and that removed charities as permissible appointees.

2. The Service ruled that it would not give effect to a local court order that modified the dispositive provisions of a trust after the government had the right to tax revenues from the trust property. As distributions could be made to charity, the IRA did not have a designated beneficiary, and minimum distributions were to be calculated using D's life expectancy based on his age at death.

D. Separate account treatment not available where trust was named as IRA beneficiary. In Ltr. Rul. 201038019, D's revocable trust named his three children as beneficiaries and as successor co-trustees. D had two IRAs that named the trust as beneficiary. The children propose to divide each IRA into three IRAs, with the children each having two IRAs for his or her benefit. Subsequently, by means of trustee-to-trustee transfers, the six IRAs would be established in D's name without containing any reference to the trust. Will that work, enabling

1. Sorry, said the Service. The "separate account" rule is not applicable in this situation. Because at the time of D's death the trust (and not the children) was the named beneficiary, the separate account rules were inapplicable, and required minimum distributions to be made from the IRAs will be determined using the life expectancy of the oldest child.

III. Section 671—Grantor Trusts

A. Section 678 beneficiary-grantor trust qualifies as a Sub-S shareholder. Your client (A) is the sole shareholder of Company, which has filed a §1362 election to be treated as an S Corporation. A wants to get a portion of the stock settled in a trust that will benefit A and his children without disqualifying Company's Sub-S status. How should he go about it?

1. Here's one way. Under the facts of Ltr. Rul. 201039010, B created an irrevocable Trust for the benefit of A and A's children. The independent trustee of Trust was given absolute discretion to distribute income to any one or more of the beneficiaries. Under the trust agreement, whenever a gift is made to Trust during B's lifetime, A has the power to withdraw from Trust an amount not to exceed the amount of the gift, with the amount subject to withdrawal in any calendar year limited to the "$5,000 or 5 percent" provisions of §§2041(b)(2) and 2514(e). In each of two years, B made gifts of cash in amounts not greater than the amounts subject to A's withdrawal power. A did not exercise the withdrawal power in either year. The trustee of Trust now wants to purchase stock in Company. A and Company requested rulings that A will be treated as owner of Trust under §678 and that Trust is a permitted S corporation.

2. That will work, said the Service. A will be treated as the owner of Trust under §678 and Trust is a permitted S corporation shareholder, "assuming no gift is made to Trust in excess of the amount subject to A's withdrawal power."

IV. Section 2031—Definition of Gross Estate—Valuation Issues

A. **Valuation of a partnership interest? Maybe a bench trial would have been a better idea.** In *Levy v. United States*, 2010-2 U.S.T.C. ¶60,608 (5th Cir. 2010), the estate sought a refund of $3.2 million in estate taxes. At issue was valuation of the decedent's interest in a real estate partnership. A jury determined that a parcel of real estate held in the partnership should be valued at $25 million, the actual price for which the property was eventually sold. The court held that the estate was not entitled to a refund due because there was no reversible error in the trial court's evidentiary rulings, denial of a new trial, and jury instructions. The denial of a new trial was proper because the Service provided ample evidence to support the jury's decision. Although the parties had previously agreed that the court would determine the appropriate discount for decedent's interest in the partnership, the estate failed to object to the inclusion of a jury question and instructions regarding the discount. The jury verdict of $25 million was reached without allowing any discount for lack of control and marketability.

V. Section 2032—Alternate Valuation

A. **Accountant failed to consider alternate valuation; extension granted.** In Ltr. Rul. 201103003, the accountant originally hired to prepare the estate tax return died before completing the return. An extension to file the return was granted and a second accountant completed and timely filed the return. This accountant, however, failed to consider the alternate valuation date election. After discovering the oversight, the executor requested, and was granted, an extension to file a supplemental information return making that election. The estate had acted reasonably and in good faith in relying on a qualified tax professional.

VI. Section 2033—Property In Which Decedent Had Interest

A. **He may have had a history of shady dealings, but he didn't own the warehouse company**. In *Estate of Fortunato v. Commissioner*, T.C. Memo 2010-105, after spending six years in Sing Sing, Bobby Soprano—er, Fortunato became a co-owner and president of a large exporting company in New Jersey. Because of financial problems, the company closed in 1984, owing $490,000 in penalties to the IRS and large amounts to overseas creditors, including "some who allegedly belonged to the Chinese mafia."

1. In 1985, Bobby's younger brother Anthony incorporated St. George Trucking and Warehousing Inc.. From time to time, Bobby acted as Anthony's business strategist. Bobby later began to work for St. George full time and assumed a leadership role. However, he had no business title and was not on the company's payroll. Each week, a St. George employee would write a check to a fictitious person, cash the check, and place the proceeds in the company's safe for Bobby's use. This procedure avoided the inconvenience of Bobby having to file income tax returns or pay taxes. The company expanded, and Bobby opened an office in Southern California. As in the New Jersey office, Bobby had no business title at the California office. Bobby hid from his creditors, fearful that they would discover him, kept no bank account, and refused to sign his name on any document.

2. Bobby's unique compensation scheme continued. However, he did file federal tax returns to take advantage of an IRS tax amnesty program—reporting income of $30,000 per year when he was actually receiving between $200,000 and $1.2 million a year. Because the California CFO believed that Bobby was the owner of the California office, payments made to Bobby were recorded as officer salary, professional fees, or notes payable to stockholders. The company also paid Bobby's personal expenses. When the business expanded to Atlanta, Bobby inquired into the possibility of buying out Anthony, but he died before offering a buyout proposal.

3. After examining these rather intriguing facts and applicable state law, the Tax Court ruled that Bobby did not hold an ownership interest in the warehouse companies. The record showed that Bobby never desired or intended to be a shareholder of the companies because he was fearful that if his creditors were aware of any assets owned by him, they would attempt to collect their debt. Further, Bobby was concerned that his past criminal convictions would stigmatize any company in which he had an ownership interest. Finally, Bobby had none of the financial burdens associated with equity ownership.

VII. Sections 2036 and 2038—Retained Interests or Powers

A. No gross estate inclusion and fractional interest discount where parent deeded 49 percent interest in residence to son; parent and son resided in the residence. The scenario: Adult Son lives with Mother in a $2 million residence owned by Mother. Mother deeds a 49 percent interest in the residence to Son and files a gift tax return that takes a 20 percent fractional interest discount. Thus, the gift tax return reports a taxable gift of [$980,000 -$196,000 discount -$13,000 annual exclusion =] $771,000. No gift tax is paid because of Mother's $1 million gift tax exemption equivalent. Mother dies a year later; the residence has increased in value to $2.1 million. The executor files an estate tax return that reports an adjusted taxable gift of $771,000 and, taking a 20 percent discount, reports [$1,071,000 (51 percent of $2.1 million) -$214,200 discount =] $858,600 as the value of Mother's interest in the residence.

1. My assumption of a 20 percent discount is very conservative. If 40 percent discounts were taken, the taxable gift would be [$980,000 - $392,000 discount - $13,000 annual exclusion =] $575,000, and the gross estate inclusion would be [$1,071,000 - $438,400 discount =] $642.600.

2. Note the benefits if this works. (i) The adjusted taxable gift inclusion was reduced by a fractional interest discount with respect to the donated 49 percent interest. (ii) A portion of the property's appreciation in value (49 percent) is removed from the estate tax base. (iii) The value of the 51 percent interest retained by Mother qualifies for a fractional interest discount—and (iv) Mother was able to continue residing in her home until she died.

3. Does it work? In *Estate of Stewart v. Commissioner*, 617 F.3d 148 (2nd Cir. 2010), the Court of Appeals for the Second Circuit said YES—or, more precisely, gave a qualified yes. The facts were essentially the same as (but somewhat more complicated than) the scenario outlined above. Mother and Son resided on the first two floors of a five-story brownstone in Manhattan owned by Mother. The top three floors were leased to a commercial tenant for a rental of $9,000 per month. They also owned as joint tenants an East Hampton home which they rented out during the summers, splitting the income and expenses. Mother was diagnosed with pancreatic cancer in December, began chemotherapy in January, deeded the 49 percent interest in the Manhattan home to Son in April, and died in November. In the six-month period from the date of the gift to the date of Mother's death, the rental payments for the top three floors (which were erratic during this period) were all paid to Mother. Expenses

on those three floors, abnormally high during this period, were paid primarily by Mother ($21,800 by Mother, $2,000 by Son). During the six-month period, Son received all of the income from the East Hampton property but (unlike in prior years) did not split that income with Mother.

a. The Manhattan property appreciated in value by $125,000 from the date of the gift to the date of Mother's death.

b. The parties stipulated that if the entire value of the Manhattan property were not includible in Mother's estate, there was to be a 42.5 percent discount for lack of control and lack of marketability .

4. The government contended that the full value of the property was includible in Mother's gross estate under §2036—meaning, of course, that no fractional interest discounts would be involved. The Tax Court agreed (T.C. Memo. 2006-225), finding an implied agreement that Mother would retain possession or enjoyment of the transferred 49 percent interest. In reaching this conclusion, the Tax Court pointed to Mother's receipt of all of the rental income during the six-month period. The court concluded that Son's testimony as to a purported agreement, that the parties would split the income from the Manhattan and East Hampton properties and reconcile the receipts and expenses at the end of the year, was not credible.

5. The Court of Appeals reversed in a 2-1 decision. The court held that even under a clear error standard, the Tax Court erred in finding an implied agreement of retained enjoyment with respect to the entire 49 percent interest. As for the two floors occupied by Mother and Son, Son "manifestly enjoyed, and Decedent did not, the benefits of the residential portion of the 49 percent." As to the rental portion, "it seems that Decedent retained less than the total 49 percent." The case was remained to the Tax Court for a determination as to the extent of Mother's retained interest in the rented-out portion, and gave suggestions as to how this might be determined.

a. The majority opinion (and the dissenting opinion) gives extend discussion to a number of "implied retention" cases. The court pointed out that where the donor retained exclusive possession after gifting the property, the taxpayer always loses. See, *e.g.*, *Estate of Linderme v. Commissioner*, 52 T.C. 305 (1966), where the donor deeded title to his three sons but continued to occupy the house until shortly before his death, paying no rent. If, however, there is joint occupancy that is consistent with the familial relation, the taxpayer invariably wins. Several cases have involved spouses, as in *Union Planters National Bank v. United States*, 361 F.2d 662 (6th Cir. 1966), where a husband deeded his interest in a tenancy by the entireties to his wife but continued reside with her in the home. The husband's continuing occupancy with his was "a natural incident to the marital relationship." The principle has been extended to cases where (*e.g.*,) an elderly father deeded the residence to his daughter and then resided with the daughter and her family. *Estate of Diehl v. United States*, 68-1 U.S.T.C. ¶12,506 (W.D. Tenn. 1967).

b. A vigorous dissent accused the majority of misreading and misapplying the prior case decisions. The disssent pointed out that Mother retained the income from the rental component and had the same possession of the residence portion as she had before the transfer, and that "her relationship to the property changed in *not one significant respect* from the period preceding the transfer to the period after." [Court's emphasis.] "Cohabitating family members are all but invited to engage in sham transactions that have no impact upon the transferor's possession and enjoyment of a property, and whose only purpose is tax avoidance.... The majority's reasoning, by focusing solely on Brandon Stewart's residence at the townhouse as a tenant in common as dispositive, not only departs from prior case law and contravenes the text of section 2036, but also thoroughly undermines the statute, inviting inequitable disparities among those subject to the estate and gift taxes due to easy dodges by future tax avoiders."

6. **Vacation properties** (second home in Santa Fe, condo in Vail) are particularly attractive candidates for fractional interest gifts. One deed (even of a fractional interest within annual exclusions) puts the property valuation in a discount mode. The donor's continued occasional use of the property as in the past—and in most situations the donees' continued occasional use of the property as in the past—is not inconsistent with the underlying title. It fits within a basic theme of the laws governing tenancies in common: Each cotenant has a right to occupy the commn property (regardless of the size of the fractional interest, as along as she does not exclude the other cotenants' coequal right of occupancy.

B. Are self-settled asset protection trusts includible in the grantor's gross estate? In Ltr. Rul. 200944002, G created an irrevocable trust for the benefit of himself, his spouse S, and his descendants. Under state law, the trust was a self-settled asset protection trust: the trust would not be reachable by Gr's creditors. The trustee, who was not a related or subordinate party under §672(c), could distribute income and principal to G, S, and G's descendants in the trustee's sole discretion. The beneficiaries, any spouse of a beneficiary and any related or subordinate party were prohibited from being a trustee. The trust was a grantor trust because (i) G had the power, exercisable in a nonfiduciary capacity, to reacquire trust assets (§675), and (ii) distributions could be made for the benefit of G and his spouse (§677). The trustee was prohibited from reimbursing G for income taxes for which G was liable as a result of the grantor trust status.

1. G requested a ruling on whether transfers to the trust would be completed gifts, and whether the trust assets would be included in G's gross estate. The Service ruled that, because G did not retain the power to vest the beneficial title in himself or to change the interests of the beneficiaries, transfers to the trust would be completed gifts. The Service declined to rule on the estate tax inclusion question.

    a. The ruling did note, however, that G's retained substitution power would not, by itself, cause an estate tax inclusion. This holding follows Rev. Rul. 2008-22, 2008-16, IRB 796, which stated that as long as the trustee has a fiduciary obligation (under local law or the trust instrument) to ensure that properties acquired and substituted by the grantor are in fact of equivalent value and the substitution power cannot be exercised in a manner that shifts beneficial enjoyment, the substitution power will not cause an estate tax inclusion.

    b. Also, because the trustee was prohibited from reimbursing G for any income taxes paid, there was no risk of estate tax inclusion from reimbursement. (Under Rev. Rul. 2004-64, 2004-2 C.B. 7, a mandatory tax reimbursement clause does cause inclusion under §2036, but a discretionary ability to reimburse the taxpayer does not, as long as there is no pre-existing arrangement to do so.

    c. Finally, the Service ruled that the trustee's discretion to distribute income and principal to G did not, by itself, cause inclusion under §2036. It refused, however, to rule on whether such beneficial interest, in combination with other facts, such as an understanding or pre-existing arrangement between the taxpayer and the trustee, could cause estate tax inclusion. The bottom line is that self-settled asset protection trusts are vulnerable to a "facts and circumstances" or "implied agreement" test that could trigger a §2036 inclusion.

C. Deed gave fractional interests of remainder interests, but grantor retained right to possession. In *Estate of Adler v. Commissioner*, T.C. Memo 2011-28, Adler owned a 1,100-acre tract of land in

Carmel, California. A 1965 deed conveyed one-fifth interests in the land to Adler’s five children. However, the deed expressly reserved to Adler the "full use, control, income and possession" of the property for his natural life. Not surprisingly, the Tax Court ruled that, as Adler had made a transfer with a retained right to possession for life, the full $6.4 million value of the land was includible in Adler’s gross estate, with no fractional interest discounts.

D. **After all of those deeds, grantor still retained possession of the property for life**. In *Estate of Van v. Commissioner*, T.C. Memo 2011-22, Van purchased a home in San Mateo, California for $250,000, but the $170,000 downpayment and the $80,000 in note payments were all made by Van’s daughter and son-in-law. Immediately after acquiring title, Van conveyed to herself and two grandchildren as joint tenants. Some years later, the grandchildren conveyed their interest back to Van Some years later, Van transferred title to a revocable trust and, several years after that transferred title to herself as trustee for a daughter and grandchildren. However, “Van retained possession or enjoyment of the … house until she died, even after title to it began ducking and weaving throughout her extended family.” Thus, the full value of the house was includible in Van’s gross estate as a transfer with a retained life estate.

1. **No purchase money resulting trust on these facts**. The estate contended that a purchase money resulting trust in favor of the daughter and son-in-law should be found, as they furnished the consideration for the property’s acquisition. In California, however (as in most states), no presumption of resulting trust arises when the transaction is between child and parent. Instead, a presumption of gift arises. Moreover, the circumstances surrounding the purchase of the home led to the conclusion that neither Van nor her daughter and son-in-law intended that she was taking title only on the couple’s behalf.

VIII. Section 2041—General Powers of Appointment

A. **Ascertainable standard issue: modification to clarify meaning of “or other life emergency” passes muster.** In Ltr. Rul. 201039003, a trust gave the income beneficiary-trustees the power to advance income to a beneficiary for “reasonable care, maintenance, or education, or on account of any illness, infirmity, ***or other life emergency.***” The Service approved a judicial modification clarifying that “or other emergency” modified the trust’s ascertainable standard provisions. Noting that the applicable state law gave no guidance as to the construction of “or other emergency,” the ruling reviewed relevant court decision to make its determination. Citing *Estate of Budd v. Commissioner*, 49 T.C. 468 (1968), and *Estate of Pardee v. Commissioner*, 49 T.C. 140 (1967), the Service ruled that the use of the word “other” before the word “emergency” limited the meaning of the emergency to the type of emergencies that could arise with respect to the ascertainable standard provisions. As a consequence, the beneficiary-trustees were not treated as having released a general power of appointment as a result of the trust modification.

1. The ruling also determined that division of the trust into five trusts for the benefit of the settlor’s grandchildren and great-grandchildren did not affect the trusts’ GST-grandfathered status.

B. **Modification to restrict “5 or 5” drawdown power to month of January approved.** Two trusts in Ltr. Rul. 201042004 gave the trustee-income beneficiary an annual noncumulative power to withdraw principal not to exceed five percent of the trust assets. Oops! The trusts did not limit the time period during which the withdrawal power could be exercised, meaning that regardless of the day on which the beneficiary died, five percent of the trust’s value would be includible in his gross estate under §2042.

1. The Service gave its blessing to a state court modification that limited exercise of the beneficiary's withdrawal power to the month of January. The ruling also concluded that merger of the two trusts (which had nearly identical terms) into one trust would not affect the trusts' GST-grandfathered status.

IX. Section 2053—Administration Expense Deduction

A. **In this case, interest on loan to pay estate taxes was not deductible**. So ruled in *Estate of Stick v. Commissioner*, T.C. Memo 2010-192, D's trust, which was the residuary beneficiary of his estate, borrowed $1.5 million from Foundation to pay the estate's federal and state estate tax liabilities. The estate deducted $656,250 of interest on the loan, and also took interest expense deductions on its Forms 1041. No go, said the Tax Court. Because the estate presented no evidence to establish that the loan was necessary to meet its tax obligations, the estate did not prove that the government's denial of the deduction was in error. In addition, the estate appeared to have sufficient liquid assets to pay the tax obligations without having to borrow the funds.

B. **But these were proper medical expenses!** (I couldn't pass this one up either.) In *Halby v. Commissioner*, T.C. Memo. 2009-204, H claimed medical expense deductions that included "therapeutic sex" and "massage therapy to relieve osteoarthritis and enhance erectile function through frequent orgasm." H also claimed medical expense deductions for pornography, which he claims to have sometimes used in lieu of taking Viagra. H supported the deductions from entries in a journal in which he recorded his visits to prostitutes (referred to in the journal as "service providers") and their costs, as well as the cost of pornography and books on sex therapy.

1. The Tax Court was not impressed, and denied the deductions. Moreover, "[p]etitioner did not have reasonable cause or a reasonable basis for claiming the deductions at issue. Petitioner has been an attorney for 40 years and specialized in tax law. Petitioner should have known that his visits to prostitutes in New York were illegal and that section 213, the regulations thereunder, and case law do not support his claimed deductions. Accordingly, petitioner is liable for the section 6662 [accuracy-related] penalty."

X. Section 2055—Charitable Deduction

A. **After reformation to correct scrivener's error, CRUT passes muster**. In Ltr. Rul. 201016033, H and W established a CRUT, with the remainder be distributed to Foundation. In its definition of a qualifying organization, the trust made reference to §170(b)(1)(A), which would prevent Foundation from qualifying as a charitable remainderman. The Service approved a reformation that will delete the reference to §170(b)(1)(A) on the ground of scrivener's error. As a result, H's estate qualified for a charitable deduction.

1. H and W retained the power to change the charitable remainderman designated in the trust instrument. As the power related only to the charitable remainder, the value of that interest was includible in H's gross estate—but qualified for an estate tax charitable deduction.

B. **CRUT payout rate was higher than client intended; reformation approved**. In Lrt. Rul. 201026005, an attorney drafted a charitable remainder unitrust for a client that, due to "scrivener's error," provided for a higher percentage payout than the client intended. With all parties consenting to the reformation, a local court entered an order amending the unitrust amount retroactively, conditioned upon a ruling from the Service that the trust would be a valid CRUT since its inception. Noting that the client returned the excess amounts and all accrued interest to the CRUT and did not take a charitable deduction for the overpaid unitrust amount, the Service approved the reformation.

C. Distribution of appreciated securities from CLAT results in gain to grantor. Ltr. Rul. 200920031 involved a charitable lead annuity trust, with annuity amounts payable to Foundation for 20 years. The CLAT was a grantor trust, as the grantor had the power to substitute assets of equivalent value exercisable in a nonfiduciary capacity. The Service ruled that distributions of appreciated securities would be in satisfaction of an obligation to pay a fixed amount to charity, and therefore would trigger gain to the grantor. Rev. Rul. 55-410, 1955-1 C.B. 297, which ruled that satisfaction of a pledge to charity did not result in realization of gain or loss, was distinguished because a pledge did not establish an enforceable debt.

D. Property passing pursuant to settlement qualified for deduction. In *Estate of Palumbo v. United States*, 2011 WL 860418 (W.D. Pa. 2011) (unpublished) had created a charitable trust. At the time P died, a 1999 will was in effect. The will's residuary clause was supposed to name the charitable trust as the trust remainder beneficiary, but due to a scrivener's error the will contained no such provision. As a result, P's son claimed he was the sole heir and was entitled to the residuary estate.The parties reached a settlement agreed to by P's son, the charitable trust, P's wife and his daughter-in-law and wife, and the Pennsylvania attorney general. Under the settlement agreement, the trust received $11.7 million and P's son received $5.6 million and real property. The agreement was approved in a state court.

1. The court held that P's estate was entitled to a $11.7 million charitable deduction. P "repeatedly manifested his intent to leave the residuary of his estate to the Charitable Trust as is evidenced by earlier iterations of his Last Will and Testament and other documents provided to this Court by the parties." P's attorney had admitted to making the error in preparing the Will during a malpractice action brought against him. Because the negotiations were held at arm's length, all of the legatees signed the settlement agreement (which was approved by the court and there is no evidence of collusion among the parties to the agreement or their respective attorneys, the charitable donation should be allowed.

XI. Section 2056—Marital Deduction

A. Long-term relationship did not add up to a common-law marriage; marital deduction denied. In *Beat v. United States*, 2010-2 U.S.T.C. ¶60,602 (D. Kan. 2010), D and S (named as executor under D's will) were in a romantic relationship for 26 years, which began while each was married to another person. However, the evidence established that the couple did not hold themselves out to be married, as required for a common-law marriage under state law. To the contrary, the evidence showed that the couple worked to avoid the implication that they were married, and even tried to conceal their relationship at times. They reported that they were single on all property conveyances, business transactions, and tax filings. Evidence was presented showing that D was aware of the potential estate tax savings that the marital deduction would provide, but chose to consider himself unmarried. The executor's contention that she claimed the marital deduction in good faith was unconvincing. D's attorney testified that he told S that she was not D's common-law wife, and there was evidence that S concealed certain information from her attorney in order to establish that such a marriage existed.

1. **Duty of consistency was also a bar**. During the course of their relationship, D and S filed separate income tax returns on which they claimed to be either single or head of a household. S now attempted to change her position regarding their relationship status after the statute of limitations for the income tax returns had expired. Because the IRS relied on S's and D's representations that they were not married and the Service was barred from claiming otherwise by the statute of limitations, S was estopped from claiming a marital deduction under the duty of consistency.

B. Property received pursuant to settlement agreement qualified for deduction. In Ltr. Rul. 201046004, the terms of an irrevocable trust were inconsistent with the terms of the marital agreement D and S had entered into. S and D's daughter from an earlier marriage both obtained legal representation to resolve the inconsistencies. Because the amount S received in the settlement was the product of arm's length negotiations and the interests each received reflected their economic interests, the property passing to S pursuant to the settlement agreement qualified for the marital deduction.

C. Protective QTIP election was made too late. In *Estate of Le Caer v. Commissioner*, 135 T.C. No. 14 (2010), a QTIP election was made on D's timely filed estate tax return with respect to a certain portion of D's gross estate. Three years after the return was filed, the estate's attorney filed a document purporting to make a protective QTIP election with respect to D's personal residence. Too late, said the Service. Under Reg. §20.2056-7(b)(i), a protective QTIP election must be made no later than the due date for the estate tax return.

D. Extension granted to make QTIP election. In Ltr. Rul. 201020002, on D's death his share of a revocable trust was divided into a Unified Credit Trust and a Marital Trust pursuant to a pay-no-tax formula clause. The Form 706 for the estate made no QTIP election, as no assets passed to the Marital Trust—or so they thought. After the return was filed, S learned that D's estate had additional assets, which S believed D had sold years earlier. Because the estate acted reasonably and in good faith in not making a QTIP election for the now-funded Marital Trust, the Service granted an extension to make the election.

1. In Ltr. Rul. 201025021, W created an irrevocable trust for the benefit of her husband H. The trust included a statement that W intended "to the extent that QTIP elections are made on the gift tax returns with respect to Trust, to be entitled to the maximum federal gift tax marital deduction." Despite this clear signal in the trust, the law firm that prepared and filed W's gift tax return did not make a QTIP election on the return. When the oversight was discovered after H's death, the Service granted an extension of time to make the QTIP election, as S had relied on a qualified tax professional.

2. Interestingly, the above-cited ruling did not address the Service's contrary ruling in Ltr. Rul. 200314012, in which the Service determined that it did not have the discretion to grant an extension of time to make a QTIP election, on the ground that the relevant statute was applicable only to requests of extensions of time set by regulation, and the time for making an inter vivos QTIP election was fixed by statute. It is perhaps relevant that the taxpayer in Ltr. Rul. 200314012 did not timely file a gift tax return reporting the transfer at issue.

XII. Section 2503—Taxable Gifts

A. No annual exclusions for gifts of FLP interests. So held in *Price v. Commissioner*, T.C. Memo. 2010-2, in which the court ruled that gifts of LP interests to three children over a three-year period did not constitute present interest gifts. Aside from the annual exclusion issue, the government did not contest the gift tax valuation of the LP interests even though "substantial discounts" were involved.

1. Wait a minute! Two donors, three donees, three years and $10,000 annual exclusions—this means that only $90,000 of taxable gifts by each donor were in issue. One senses that the Service was not just telling the Price family but also other donors of LP interests: Don't just assume that you're entitled to an annual exclusion; the donee must be given a present interest.

2. The interests were not present interests because the donees had no ability to withdraw their capital accounts, and partners could not sell their interests without the consent of all other partners. Moreover, the donees had no present right to income because distributions of profits were in the general partner's discretion, and the partnership agreement stated that distributions were secondary to the purpose of generating a long-term rate of return.

B. Same result in another recent case—no annual exclusions for gifts of LLC interests. Commentators have suggested that a present interest is created (and annual exclusions are secured) if the donee is given the right to sell his interest subject to a right of first refusal by other partners—or, in the case of a limited liability company, by the LLC. *Fisher v. United States*, 105 AFTR 2d 2010-1347 (S.D. Ind. 2010), held otherwise—but the terms of the right of first refusal were unusually restrictive. The principal asset of the LLC was undeveloped beach property. The donors had given membership interests in the LLC to their seven children over three years, for a total of 42 annual exclusions—or so they thought.

1. **No unrestricted right to receive distributions**. The donors argued first that the donees had the unrestricted right to receive distributions. No go, said the court, because distributions were subject to a number of contingencies, all of which were in the discretion of the general manager.

2. **No unrestricted right to use the property**. The donors argued, next, that the children possessed the unrestricted right to use the beachfront property. The court responded by pointing out that the Operating Agreement did not convey such a right to the members.

3. **The right of first refusal wasn't worth very much**. While the children could sell their interests under certain conditions, the LLC had a right of first refusal over such a transfer. The kicker was that if the LLC exercised this right, it would pay with *non-negotiable* notes payable over a period not to exceed 15 years. As a result, said the court, any such transfer would not give the donees an interest of "immediate value."

C. How, then, to secure annual exclusions for gifts of FLP or LLC interests? While a more carefully crrafted right of first refusal is one good approach, giving the beneficiary a Crummey withdrawal right also works well.

D. Drafting the Crummey withdrawal right—how to avoid a serious drafting error. More than a few Crummey withdrawal provisions are drafted along the following lines:

> Notwithstanding any other provisions of the trust, the trustee shall, ***within seven days after receipt*** of any additional contributions to the trust by the Grantor or any other person, give written notice to each beneficiary of the addition to the trust, whereupon each such beneficiary shall have the unrestricted right ***for a period of 30 days after the date of the receipt of such notice*** to demand and withdraw from the trust a share of such property equal in value to….

1. The problem: What if the trustee gives written notice but not within the seven-day period; or—as happens all too often—the trustee does not give the beneficiary written notice at all? Because the beneficiary's right to make a demand is conditioned upon the timely receipt of written notice from the trustee, if no such notice is given the beneficiary has no demand right, and the addition does not qualify for an annual exclusion.

2. Solution: The Crummey withdrawal right should be drafted along the following lines:

> If at any time any additional contribution is made to the trust by the Grantor or any other person, each such designated beneficiary of the addition to the trust, whereupon each such

beneficiary shall have the absolute right, at all times during the 30-day period commencing at the time of such addition, to withdraw from such addition….

a. But isn't there a problem if the beneficiary does not know that an addition to the trust has been made? The answer is no. In *Crummey v. Commissioner*, 397 F.2d 82 (9th Cir. 1968), the beneficiaries did not know that additions had been made to the trust. In fact, the Crummey children did not know that a trust existed that gave them a demand right! See *Commissioner v. Estate of Noel*, 360 U.S. 678 (1965): Application of the estate tax "depends on a general legal power to exercise ownership, without regard to the owner's ability to exercise it at a particular moment."

XIII. Section 2512—Valuation of Gifts

A. "Defined value" clause upheld in gifts of LLC interests. In *Petter v. Commissioner*, T.C. Memo. 2009-280 (2010) (appealable to the Ninth Circuit), the Tax Court rejected the Service's public policy arguments against the use of defined value clauses in making gifts of hard-to-value interests. With the Eighth Circuit's rejection of those arguments in *Christiansen v. Commissioner*, 586 F.3d 1061 (8th Cir. 2009), and *McCord v. Commissioner*, 2006 WL 2411543 (5th Cir. 2006), this leads to two important conclusions. (1) Arguing against the validity of defined clauses, at least of the type of clauses involved in *Petter* and *Christiansen*, now appears to be a lost cause as far as the Service is concerned. Indeed, the government's next challenge to the validity of such clauses would likely lead to the imposition of court costs and attorney's fees under §7430 by taking a position that is not "substantially justified." See *Estate of Perry v. Commissioner*, 93 F.2d 1252 (5th Cir. 2005): "A policy decision to continue to whip a dead horse in circuit after circuit in the hope, however vain, of establishing a conflict is clearly an option within the discretion of the Commissioner. That does not, however, substantially justify his causing an innocent taxpayer in each other circuit to expend attorneys' fees for the dubious honor of being the Commissioner's guinea pig." (2) In cases involving hard-to-value assets, practitioners should give serious consideration to recommending the form of defined value clauses that these two decisions have approved.

1. Mother, having transferred $22.6 million of UPS stock to an LLC, created trusts for two of her children, with grantor trust status established by giving the trustee a power to purchase and pay premiums on life insurance on Mother's life. Mother then made gifts and sales of LLC units to the grantor trusts, with the gifts comprising about 10 percent of each trust's assets. (The court noted, and tacitly approved, that the attorney indicated that he believed that a "trust capitalized with a gift of at least 10% of its assets would be viewed by the IRS as a legitimate, arms-length purchaser in the later sale.") Mother's gift was of 940 LLC units to each of the children's trusts and to a donor advised fund of the Seattle Foundation. The gift to each children's trust was "the number of units … that equals one-half of the maximum dollar amount that can pass free for federal gift tax by reason of Transferor's applicable exclusion amount allowed by Code Section 2010(c)." The gift to Seattle Foundation was the difference between (i) the total 940 units transferred and (ii) the units transferred to that child's trust under the formula gift.

   a. Three days later, Mother transferred 8,459 LLC units in separate transactions relating to each of the grantor trusts and several Community Foundations. The assignment document allocated the units by formula, with each trust receiving units worth $4,085,190 "as finally determined for federal gift tax purposes," and with any excess units passing to Foundations. In return, each trust gave Mother a 20-year secured note for $4,085,190. There were reallocation provisions that applied if either party received more than its appropriate number of units after values were finally determined.

b. The gift tax return, based on a formal appraisal, took a 53.2 percent discount, and the units were allocated accordingly. The return made a full disclosure of the gift transaction and also the sales transaction (as to the latter, no doubt to start the statute of limitations running). In the court's words, "she hid nothing." On audit, the Service (i) determined that discounts should be limited to 29.2 percent, (ii) took the position that the reallocation clause would not be recognized for gift tax purposes even if additional units passed to Foundations, and (iii) disallowed a charitable deduction for any units passing to Foundations. Mother's estate (Mother having died) filed a petition in the Tax Court. The parties settled on a 35 percent discount, but issues (ii) and (iii) were before the court.

2. **Formula allocation clauses were not against public policy**. After a review of case decisions dealing with "savings clauses," the Tax Court ruled that the *Petter* formula allocation provisions were not against public policy. "We have no doubt that behind these complex transactions lay Anne's simple intent to pass on as much as she could to her children and grandchildren without having to pay gift tax, and to give the rest to charities in her community…. The formulas used to effect these transfers were not "void as contrary to public policy … and indeed no overarching public policy against these types of arrangements in the first place." The court gave four reasons why the formula allocations in the gift and sale transactions were not against public policy.

   a. **Public policy encourages charitable gifts**. The court noted that Foundations, which were involved in establishing the arrangements, were "sticking up for their interests and not just passively helping a putative donor reduce her tax bill."

   b. **Other "potential sources of enforcement."** The LLC managers owed fiduciary to Foundations, and could police the trusts for "shady dealings." Directors of Foundations owed fiduciary duties to insure that the appraisal was acceptable before signing off on the gift.

   c. **Charitable status could be revoked**. The Commissioner could revoke the Foundations' 501(c)(3) status "if he found they were acting in cahoots with a tax-dodging donor."

   d. **The state attorney general "is charged with enforcing charities' rights."**

3. **Other formula clauses have been sanctioned by regulations**. The court noted that IRS regulations recognize formula clauses in describing annuity amounts in charitable remainder annuity trusts, formula marital deduction clauses, formula GST exemption allocations of "the unused portion of my GST exemption," formula disclaimers, and formula descriptions of annuity amounts in grantor retained annuity trusts. This shows, said the court, that there cannot be a general public policy against formula provisions.

4. The government has filed an appeal of the *Petter* decision to the 9th Circuit.

B. How about a defined value clause in the instrument of transfer? *Petter, Christiansen* and *McCord* all involved allocations to charity of interests in excess of the defined value amount, and the opinions in those case attached considerable significance to the fact that a charity was in the picture. But what if a charity is not involved? Suppose that the instrument of transfer reads as follows: "I, [donee], a limited partner of XYZ, give to [done] that percentage of my partnership interest in XYZ which is equal in value to the unused portion of my federal gift tax applicable exclusion amount." Or, "which is equal in value to $488,129" [which is dollar amount of the unused portion of the donor's gift tax exemption equivalent].

C. Valuation of undivided interests held in QPRT. In *Ludwick v. Commissioner*, T.C. Memo 2010-104, H and W purchased unimproved real property in Hawaii as tenants in common and constructed a vacation home. In 2005, they each created QPRTs at a time when the fair market value of the property was $7.25 million and had annual operating costs of $350,000. On their gift tax returns, the taxpayers applied a 30 percent undivided interest discount. The IRS deficiency allowed a discount of only 15 percent, and the government's brief argued for a discount of 11 percent.

1. Judge Halpern valued the interests by assuming that a two-year partition action would be required (resulting in a 26.5 percent discount) and assuming that the property could be sold in one year without a partition action (resulting in a 16.2 percent discount). Concluding that there was a 90 percent likelihood that no partition action would be needed (partly in reliance on the taxpayers having the burden of proof), the judge weighted those outcomes, resulting in a weighted discount of 17.2 percent.

2. For many years, the Service took the position that the only discount available for valuing undivided interests in real property is the cost of partition. See, *e.g.*, Ltr. Rul. (T.A.M.) 9336002. Cases have consistently rejected that approach, taking the position that the cost of a partition action is merely one of the factors to consider. See, *e.g.*, *Estate of Williams v. Commissioner*, T.C. Memo 1998-59; *Estate of Baird v. Commissioner*, T.C. Memo 2001-258. In *Estate of Baird v. Commissioner*, the Fifth Circuit determined that the estate was entitled to court costs and attorney's fees under §7477 because the Service's position, that the only discount allowable was the cost of partitioning the property, was not substantially justified. *Estate of Baird v. Commissioner*, 416 F.3d 442 (5th Cir. 2005), rev'g T.C. Memo 2002-299.

XIV. Section 2518—Qualified Disclaimers

A. Phew! Disclaimer based on attorney's incorrect advice could be rescinded. In *Breakiron v. Breakiron*, 2010-2 U.S.T.C. ¶60,597 (C.D. Mass. 2010), B's parents had created a ten-year qualified personal residence trust of which B was the remainder beneficiary. When the QPRT term expired, B wanted to transfer his interest to his sister, but he was concerned about the potential gift tax implications. He consulted with an attorney, who advised him that he could make a qualified disclaimer and transfer the property to his sister, as long as the disclaimer was made within nine months of the expiration of QPRTs' term. (Ouch!) B followed D's advice, and the result was a non-qualified disclaimer and a gift tax liability of $2.3 million.

1. Under Massachusetts law, a disclaimer may be rescinded if the disclaimer was executed based on a mistake that frustrated the purpose of the transfer. Accordingly, the local court rescinded the disclaimer. Because the Commissioner was named as a party to the case and because the disclaimers were based on a mistake, the rescission of the disclaimer was conclusive of the federal tax liability.

b. Ouch! Disclaimer of interest passing under will did not apply to interest passing by intestacy. In *Estate of Tatum v. United States*, 2010-2 U.S.T.C. ¶60,607 (S.D. Miss. 2010), in 1987 T executed a timely disclaimer of his interest in certain assets passing to him under his father's will. After receiving the probate court's blessing that the disclaimer was valid, T distributed the property to his children. Because the will did not contain any provision relating to the effect of a disclaimer and Mississippi law was silent on the issue, the court had to decide how the highest court in Mississippi would likely rule on the question. Based on Ltr. Rul. (T.A.M.) 9417002, the court determined that the Mississippi Supreme Court would rule that the disclaimed would pass by intestate succession—to T. Because T had not disclaimed any interest he may have received through intestacy, T had failed to make a qualified disclaimer. End result: $737,313 in gift taxes.

C. Disclaimer in favor of foundation's segregated fund was valid. In Ltr. Rul. 201032002, Daughter executed a disclaimer of all of her interest in specific assets that were to pass to Daughter's trust. The trust provided that any assets disclaimed by Daughter would be distributed to Foundation. Daughter was a director of Foundation. However, Foundation's bylaws provided that any property received as the result of a disclaimer made by any director or officer would be held in a segregated fund. Although Daughter was sole trustee of the trust that held the disclaimed assets, this did not constitute acceptance of the assets held in the trust. Therefore, Daughter had not accepted any benefit from the property, and the disclaimer was valid.

D. Disclaimer of minor's remainder interest in pre-1977 trust was made within a reasonable time. For transfers made prior to the enactment of §2518 in 1976, a disclaimer must be made within a reasonable time. In Ltr. Rul. 200953010, the Service gave its approval to the disclaimer of a beneficiary's contingent remainder interest in a pre-1977 trust made within nine months after reaching the age of majority (18 under applicable state law). Also, the beneficiary's retained right to receive discretionary distributions from the trust prior to its termination did not invalidate her disclaimer of the remainder interest. Under applicable state law, a beneficiary may make a valid disclaimer of any separate interest in property while retaining other separate interests in the same property.

XV. Section 2601—Generation-Skipping Transfer Tax

A. Lapse of general power of appointment in grandfathered trust resulted in taxable direct skip. In *Estate of Timken v. United States*, 601 F.3d 431 (6th Cir. 2010), *cert. denied*, 131 S.Ct. 905 (2011), D held a general power of appointment over a GST-grandfathered trust. The power was not exercised on D's death. The takers in default of appointment (D's nieces and a nephew) made qualified disclaimers, and the property passed to grand-nephews and grand-nieces. Following *Estate of Gerson v. United States*, 507 F.3d 435 (6th Cir. 2007) (involving the exercise of a general power of appointment), the court held that the GST grandfather exemption does not apply to the lapse as well as the exercise of a general power of appointment.

1. Because D held a general power of appointment, the value of the trust property was includible in D's gross estate. As the trust assets remained in trust after the estate taxes attributable to the trust were paid, a constructive addition to the trust was deemed to have occurred. In effect, trust assets were treated as though they had been withdrawn by D and then re-contributed to the trust.

B. Exercise of special power of appointment to extend duration of grandfathered trust. One of the nicest things to have in the family is a pre-1985 trust that gives the current beneficiary a special testamentary power of appointment. If the trust was established prior to September 25, 1985, all interests created by the exercise of the special power, including the creation of new trusts and extending the duration of existing trusts (but not beyond the period of perpetuities established by the grandfathered trust) are "grandfathered" for GST purposes. The past years rulings on this point include Ltr. Ruls. 200024017, 200024019, 199936004. In Ltr. Ruls. 199927430 and 199927444 (related cases), the Service approved Son's exercise of a special power of appointment and his resignation as trustee of a GST-exempt trust.

1. This year's addition to the list is Ltr. Rul. 201029011, where D's will exercised her power of appointment by directing that the trust property be distributed to a different trust, which ultimately was divided in shares and allocated among trusts for each of her children. Each beneficiary of a Child's Trust was granted a special testamentary power to appoint among the issue of D and her husband. The Service ruled that D's exercise of the power of appointment did not cause loss of the trusts' GST-grandfathered status.

XVII. Section 2702—Special Valuation Rules: Trust Transfers

A. **Six-month occupancy without paying rent after QPRT terminated did not result in gross estate inclusion**. In *Estate of Riese v. Commissioner*, T.C. Memo 2011-60, 80-year-old Riese received estate planning advice from attorney Stefan Tucker, a former chair of the American Bar Association Section of Taxation. This led to extensive consultations between Riese, her son-in-law and financial advisor Grimes, and Tucker. On Tucker's recommendation, Riese established a three-year QPRT for her residence in Kings Point, New York, with Tucker having made it clear that when the QPRT term expired, Riese would have to pay market rental for her continued occupancy of the residence. On termination of the QPRT, the residence was to pass into trusts for Riese's two children. The QPRT terminated on April 19, 2003. Shortly thereafter, Riese's daughter called Tucker, inquiring about how to determine the proper amount of rent to charge for Riese's continued occupancy. "Mr. Tucker explained to her that fair market rent could be determined by contacting local real estate brokers and that this could be done by the end of the year (i.e., December 31, 2003). Mr. Tucker entered a 'tickler' in his pocket calendar to remind himself to call Mrs. Grimes by Thanksgiving to make sure everything was taken care of. However, before Thanksgiving arrived decedent suffered a stroke and died unexpectedly on October 26, 2003…. We believe … that Mr. Tucker would have made sure a lease was executed, rent was determined, and all appropriate changes were made to effect the change of ownership. Unfortunately, decedent died unexpectedly in October before any of this occurred."

1. The court determined that, with the payment of rent having been discussed extensively, corroborated by the daughter's call to Tucker, Riese had agreed to pay rent after the QPRT had ended. Finding the witnesses' testimony to be credible, a tenancy at will was created. "The Secretary had not issued any regulations or guidance as to how and when rent should be paid upon the termination of a QPRT. We believe that doing so by the end of the calendar year in which the QPRT expired would have been reasonable under the circumstances."

2. After Riese's death the estate assumed responsibility for the property, paying property taxes, insurance, and maintenance expenses until the property was sold a year later. The court allowed a §2053 deduction of $46,298 in accrued rent as a debt of the decedent. However, a $46,298 claim of rent owed to the estate was disallowed. [A]s there was no formal lease between the Property Trusts and decedent, the tenancy-at-will ceased upon decedent's death. The estate did not require a roof over its head and was not obligated to pay rent." The court also disallowed a deduction for $125,000 paid to son-in-law Grimes. The estate failed to adequately explain how services provided through an investment company to the estate were a reasonable and necessary expense.

B. **QPRT modified to give remaindermen special power of appointment**. In Ltr. Rul. 201039001, S deeded her residence to a qualified personal residence trust for a term of X years. After expiration of the term, the trust was to continue for the benefit of S's issue until the death of S and her spouse, at which time the trust estate was to be distributed to S's issue per stirpes. "On Date 2, Settlor, in her capacity as Trustee of Trust, with the joinder and consent of Son 1 and Son 2 [her two adult sons], executed Modification to modify Trust." [Hmm. A nonjudicial "modification," of an irrevocable trust, apparently.] The modification provided that at the end of the QPRT term, Sons were to hold a power to appoint the trust property in equal shares to themselves or, alternatively, to direct the trustee to amend the trust so as to provide a term interest to S, her spouse, or both, as a gift by Sons. Sons exercised their power to grant S an additional term of years under the QPRT.

1. That's fine with us, said the Service. The trust modification resulted in Sons' making a gift of their term interest in the residence to S, and the QPRT exception to §§ 2702(a)(1) and (2) applies to the transfer. However, "no opinion is expressed or implied concerning whether the

transfer of Residence to Settlor, pursuant to the modification of Trust, would result in Residence being included in the gross estate of Settlor under §2036."

C. **Modification of QPRT to avoid problem with premarital agreement**. In Ltr. Rul. 201006012, G transferred House to a QPRT for a term of X years. At the expiration of the term, the trust (of which G was trustee) was to continue for the benefit of G's four adult Children. The trust was to terminate on the later of G's death or the end of the X-year period. The gift to the trust was subject to a premarital agreement that gave G's spouse S the right to occupy House for Y years if G and S married at his death and House was being used as their residence. With Children's joinder and consent, G proposes to modify the trust to give Children a power of appointment to grant G the right to occupy House for an additional term. Children would exercise the power by extending the term of the trust to Z years.

1. The Service gave its approval to the proposed transaction. Exercise of the power of appointment will result in a gift by Children, but the special valuation rule §2702 will not apply to the modification.

2. **No ruling as to estate tax consequences**. The Service did not rule on whether granting an additional term to G will cause a gross estate inclusion under §2036 if G dies before the expiration of the Z-year period.

XVII. Section 6651—Failure to File Return or Pay Tax

A. **The chutzpah defense: Reliance on a qualified tax professional???** ***You*** **were the qualified (sic) tax professional!** In *Estate of Cederloff v. United States*, 2010-2 U.S.T.C. ¶60,604 (D. Md. 2010), an estate was liable for a late-filing penalty because the executor failed to prove that he fell within the reasonable cause exception of §6651(a). The executor's reliance upon the advice of a professional was not a valid defense because the executor was the professional on whose advice he relied. Lowe, appointed as the estate's personal representative, was an experienced attorney (and former IRS attorney) whose practice includes estate law. As such, he was fully aware that he was required to file an estate tax return within nine months after the decedent's death.

XVIII. Section 6662—Imposition of Accuracy-Related Penalty

A. **Estate not subject to penalty where executor relied on disbarred "Enrolled Agent."** *Estate of Robinson v. Commissioner*, T.C. Memo. 2010-168, involved a $380,000 deficiency, a $76,000 accuracy-related penalty, and a dangerously loose cannon. D's son James was a computer programmer with a high school education. After James had acquired some rental properties, he needed help in filing his income tax returns. A friend recommended Schlaback. On a visit to Schabach's office, James noted an "Enrolled Agent" plaque on the wall. (James didn't know that Schlabach had been disbarred from practicing before the IRS.) James noticed that Schalbach's business card contained the legend "Estate Planning," and Schlabach told James that he was certified in estate planning. James' wealthy father was suffering from Alzheimer's, and pursuant to a power of attorney James had Schlabach prepare an estate plan. Part of the estate plan was to transfer assets to a "pure trust" whose assets, on D's death, were not reported on the estate tax return. After D's death, James as executor retained Schlabach to prepare the estate tax return. When Schlabach saw that the taxable estate would exceed the exemption equivalent, he advised James to establish a charitable foundation and transfer assets to the foundation, thereby securing a charitable deduction for the estate (!). James did so.

1. The estate tax return was audited and the Service assessed a deficiency—which the estate did not challenge. The Service also assessed an accuracy-related penalty, but Judge Vasquez ruled for the taxpayer. Schlabach may not have been a qualified tax professional, but James reasonably believed that he was. His reliance on Schlabch was reasonable and was made in good faith.

XIX. Section 6673—Sanctions and Costs Awarded by Courts

A. **Attorney sanctioned for jacking the Tax Court around**. In *Estate of Allison v. Commissioner*, T.C. Memo. 2008-149, D died in 1995. Her son, an attorney, was appointed as personal representative. "He opened a probate case shortly after her death in Seattle's King County Superior Court. As of 2008, the estate was still not closed. [In 1997, Allison began litigating a dispute with his sister over administration expenses in D's estate and in the estate of their father.] Mr. Allison also filed two Tax Court cases for the estate in early 2000. Neither of them has been closed. It appears that Mr. Allison has been telling our Court that resolution of the probate case is all that's needed to wrap up the Tax Court cases, and telling the King County Superior Court that resolution of the Tax Court cases is all that's needed to wrap up the probate case. We issued an order to Mr. Allison to show cause why we shouldn't sanction him for his misrepresentations. This opinion explains [chronologically and at considerable length] the reasons for our decision to make that order absolute."

1. "From the comparison of the documents filed with this Court and with the King County Superior Court, we believe that Mr. Allison is taking advantage of the calendar system of both courts to indefinitely postpone the resolution of the probate case and the Tax Court cases. We find that he deliberately and repeatedly told each court that the other matter had to be resolved first, and in doing so, he has misled and misinformed this Court."

2. The court noted that §6673 authorizes a penalty of up to $25,000 for procedures instituted primarily for delay, and also authorizes the party to pay "excess costs, expenses, and attorneys' fees reasonably incurred" if the party "has multiplied the proceedings in any case unreasonably and vexatiously." The court decided that it was appropriate to sanction Mr. Allison personally, "so that any other beneficiaries of the estate don't suffer for his actions."

   a. "Mr. Allison repeatedly requested continuances from this Court, telling us that he was pursuing the probate case diligently while repeatedly telling the probate court that he was moving forward in the Tax Court cases. He also has failed on many occasions to timely satisfy this Court's requests and orders. His failure to submit information regarding the status of the probate case that we requested in 2005 is especially notable, since it would likely have helped us catch his serial misrepresentations sooner."

   b. "Mr. Allison's education [Stanford Law School] and legal experience, not to mention his admission to the Tax Court bar, underscore the egregiousness of his conduct. The issues in both cases before us are fairly simple and should have been resolved long ago. Instead, the cases before us have dragged on for over eight years, and the probate case has lingered for more than a decade. We therefore find that he used procedures of our Court primarily for delay, and in doing so was repeatedly dishonest. Mr. Allison's persistence in the face of warnings from both courts thus warrants a penalty under section 6673(a)(2). That section requires a determination of the costs imposed on the Commissioner, and we will order the Commissioner to file evidence of what those costs were."

c. “Because Mr. Allison is an attorney currently admitted to practice before the Tax Court, other sanctions may be appropriate. We will also send this opinion (and the order to show cause dated March 7, 2008) to the King County Superior Court for their consideration.”

3. In *Estate of Allison v. Commissioner*, 2010-2 U.S.T.C. ¶60,609 (4th Cir. 2010) (unpublished), the imposition of sanctions was upheld. “We have reviewed the record and find no reversible error.”

XX. In Conclusion

A. Having a conference with a married couple for wills and estate planning advice? Here’s a question you need to ask. In *Estate of Gardiner*, 42 P.3d 2002 (Kan. 2002), 42-year-old J’Noel Ball, a Finance professor at Park University in Parkville, Missouri, married 86-year-old Marshall Gardiner in September 1998. Marshall, a long-time donor to the university, had met J’Noel at a school function. Marshall died intestate in August 1999, leaving a $2.7 million estate. He was survived by J’Noel and his 53-year-old son, Joe. Under Kansas law, J’Noel and Joe each inherited one-half of Marshall’s estate. Joe was not pleased with the situation: although he knew that his father had remarried, he met his “stepmother” for the first time at the funeral, and he didn’t like what he saw. What should Joe have done? A will contest was not an option, because there was no will. What would *you* have done on Joe’s behalf?

1. Here is what happened: ….

B. How does this case (or, rather, its fact setting) affect your practice? If a married couple comes to you for estate planning advice, what question do you need to ask them?